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Office of the Chairman
Administrative Conference of the United States

Administrative Conference of the United States

Recommendations and Reports

1988

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Administrative Conference of the United States

The Administrative Conference of the United States was established by statute as an independent agency of the federal government in 1964. Its purpose is to promote improvements in the efficiency, adequacy and fairness of procedures by which federal agencies conduct regulatory programs, administer grants and benefits, and perform related governmental functions.

To this end, the Conference conducts research and issues reports concerning various aspects of the administrative process and, when warranted, makes recommendations to the President, Congress, particular departments and agencies, and the judiciary concerning the need for procedural reforms. Implementation of Conference recommendations may be accomplished through direct action on the part of the affected agencies or legislative changes.

Office of the Chairman
Administrative Conference of the United States

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RECOMMENDATIONS
AND
STATEMENT

RECOMMENDATION 88-1:

PRESIDENTIAL TRANSITION WORKERS' CODE OF ETHICAL CONDUCT

The orderly and peaceful transfer of governmental authority following presidential elections is a hallmark of American government. The Presidential Transition Act of 1963 recognizes that a smooth transition is necessary to "assure continuity in the faithful execution of the laws and in the conduct of the affairs of the Federal Government, both domestic and foreign," and it directs all officers of the government to take steps to promote the orderly transition of power between the outgoing and incoming administrations.[1]

Since 1933, when Inauguration Day was moved forward from March 4 to January 20, the length of presidential transitions has been between 71 and 79 days. However, the size and complexity of the transition task has grown steadily over time, corresponding to the tremendous growth in federal responsibilities. Each new President-elect has required a larger and more sophisticated transition organization than his predecessor.

The President-elect's transition organization must, in this brief period, prepare to provide the new leadership with comprehensive information on the organization and responsibilities of each federal agency; on the resources within each agency, including the budget, legislative initiatives, personnel and grants or contracts; and on the policy questions that will require decision by the new administration. This information is the basis for the

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[1] 78 Stat. 153, § 2; 3 U.S.C. § 102 note.

President-elect's personnel, budgetary and policy decisions during the critical initial period of the new administration.

A large number of private citizens must be relied upon to accomplish these important tasks. During the 1980-81 presidential transition, over six hundred persons, most serving as volunteers, had active assignments on agency transition teams. Many of these persons were selected because of their substantive knowledge of the agency's mission, acquired either through past service in the government or in private sector jobs that brought them in contact with the agency. The magnitude and importance of the transition tasks, and the limited time available to complete them, suggest that future Presidents-elect will continue to rely upon large numbers of private citizens, some of whom later will be offered government appointments but many of whom will return to their private sector jobs.

The Administrative Conference wishes to encourage the participation of well qualified individuals in presidential transitions, but it recognizes that the presence of large numbers of private transition workers dealing with federal agencies offers the potential for conflicts of interest or abuse of the public trust that accompanies their special access to government information and facilities. The Conference is not acting upon knowledge of serious problems in this regard in recent transitions, but rather upon the need to prevent such problems from occurring in the future.

In this recommendation the Conference urges the President to issue an executive order to the heads of all federal agencies (including independent regulatory agencies), conditioning special access to federal agency records and facilities by members of the President-elect's transition team upon their agreement in writing to the standards of conduct set forth in the Appendix to this recommendation. The recommended executive order would cover the activities only of "special transition team members," *i.e.*, transition workers, who are not existing government employees, who serve with or without compensation, and who are authorized by the President-elect's transition organization to seek or obtain access to non-public government information. The Conference believes that private citizens are not, and should not be considered, special government employees and thereby subject to federal conflict-of-interest laws, solely because of their activities as special transition team members.

Two concerns are addressed by this recommendation. First, federal agency officials need to know who actually represents the President-elect before granting special access to information. Second, the public needs assurance that authorized transition workers will not use such information to further their own financial interests or the interests of their present or future employers or other private persons.

The Conference believes that the recommended executive order and transition standards of conduct will alleviate these concerns without reducing the flexibility of the President-elect's transition effort. By urging the President to direct federal agencies affirmatively to cooperate with authorized transition personnel to the extent permitted by law and consistent with their official duties, the recommendation should facilitate the President-elect's transition efforts.

The Conference's recommendation includes requirements contained in pending legislation to amend the Presidential Transition Act of 1963 for minimal disclosure of personal or financial information by transition team workers.[2] The Conference believes that transition team members should supply this limited information to agencies, whether or not the pending legislation is enacted. The Conference also recommends that special transition team members agree not to use non-public government information, or to take any action as transition team members which could further their own financial interests.

RECOMMENDATION

1. The Conference recommends that the President issue an executive order that conditions access by special transition team members to government facilities or non-public information upon their agreement in writing to the standards of conduct set forth in the Appendix to this recommendation. The term "special transition team member" is used herein to mean a person who is not a government employee, who serves with or without compensation as a member of a transition team, and who is

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[2] H.R. 3932, passed by the House of Representatives on March 31, 1988, and S. 2037, passed by the Senate on April 26, 1988, would require disclosure of the names of transition team workers, their most recent employment and the source of funding of their transition activities as a condition of receipt of public funds for transition activities.

authorized by the President-elect to seek or obtain access to non-public government information or facilities.

2. The executive order should direct the heads of all federal agencies to require the President-elect's transition organization to provide each agency with a list of the special transition team members for that agency, copies of their written agreements to comply with the standards of conduct and copies of information disclosure statements, as a condition of access by such members. The agencies should be required to maintain and make those documents available to the public upon request.

3. The executive order should direct all agency heads, subject to the above conditions, to cooperate with persons named by the President-elect or his designees as special transition team members to the extent permitted by law and consistent with the performance of official duties.

4. The executive order should direct all agency heads to take appropriate action against any person found to have violated the standards of conduct agreement, including, where authorized and in accordance with applicable procedures, barring the person from employment, receipt of contracts, representation of others before the agency, or referral of the matter to appropriate professional disciplinary bodies.

APPENDIX

Transition Code of Ethical Conduct

Each person who is not an employee or special government employee of the federal government and who assists in the presidential transition, with or without compensation, and who is designated by the President-elect to seek or obtain access to non-public government information or facilities during the transition period (herein referred to as a "special transition team member"), shall agree to comply with the following standards of conduct as a condition of such access.

1. **Disclosure of Information.** A special transition team member shall supply the agency with a statement as to his or her present employment and the sources of funding which support his or her transition activities.

2. **Misuse of Inside Information.** A special transition team member shall not use, permit others to use, or disclose non-public information except for the public purposes of the transition.

3. **Financial Self-Dealing.** During the transition period, a special transition team member shall not knowingly take any action on a particular matter involving the federal agency which could have a direct effect upon a financial interest of the transition team member, his or her spouse, a family member, or any individual with whom the transition team member has a business, professional or close personal relationship.

4. **Concurrent Representation in Agency Proceedings.** During the transition period, a special transition team member shall not advise or represent, with or without compensation, anyone in any particular matter involving a federal agency to which he or she has had access to non-public information. This restriction does not extend to the special transition team member's firm or organization, but the team member should advise his or her firm or organization to establish procedures to assure that the team

member does not participate in any way in any such agency proceeding.

5. **Misuse of Government Property.** A special transition team member shall conserve and protect federal property entrusted to him or her, and shall not use federal property, including equipment and supplies, other than for purposes directly related to transition activities.

6. **Post-Transition Activites.** For two years after the transition, a former special transition team member shall not represent, with or without compensation, any person before an agency in any particular matter involving a specific party or parties as to which he or she obtained government information not then available to the public and not made public prior to the request for advice or representation.

7. **Definitions.** As used in this Appendix [Order], the terms "employee," "special government employee," "particular matter"[3] and "particular matter involving a specific party or parties" shall have the same meaning as in Title 18, United States Code, §§ 202-209. The term "transition period" shall extend from the date of the general election in which the identity of the Pre sident-elect is established until Inauguration Day, or if the transition organization continues to operate after the inauguration, such later date through which the special transition team member continues to serve in that capacity.

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[3] It is noted that the term "particular matter" has been interpreted to include rulemaking and general policy matters, and extends to all discrete matters that are the subject of agency action, no matter how general the effect.

RECOMMENDATION 88-2:

FEDERAL GOVERNMENT INDEMNIFICATION OF GOVERNMENT CONTRACTORS

Indemnification of government contractors for third-party liability involves this issue: who should bear the risk of liability for injury or damage to a third party caused by products and services supplied by government contractors? This issue is especially significant when the products and services involve high-risk or hazardous governmental activities.

The liability of the government is limited by the doctrine of sovereign immunity, which has been waived only in certain situations, such as the Federal Tort Claims Act. Some courts have recognized a common law immunity for government contractors who have complied with pertinent government specifications and have disclosed all known defects or hazards to the government.[*] In the absence of insurance or indemnity, government contractors may be exposed to claims based, for example, on alleged failure to follow specifications or adequately warn the government or others about product design defects.

No government-wide legislation provides generally for indemnification of government contractors for third-party liability, although a number of individual departments and agencies are authorized to indemnify contractors.[1] All of the laws authorizing government indemnification of contractors state conditions that must be met before contractual indemnity will be granted, and designate the official who is to determine whether the conditions have been met. Thus some statutes restrict indemnification to unusually hazardous governmental activities or activities that may result in catastrophic losses and further require the contractor to obtain such insurance as is available. Indemnification clauses included in contracts usually contain further conditions, some of which are required by agency rule. A common restriction is that the indemnity does not cover claims resulting from the contractor's willful misconduct.

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[*] Subsequent to adoption of the recommendation, in a case involving military equipment, the Supreme Court accepted this view. See *Boyle v. United Technologies*, 108 S. Ct. 2510 (1988).

Indemnification clauses are reserved for unusual circumstances, and few contractors are actually provided with indemnity. The Department of Defense, for example, included indemnification clauses in an average of about 70 contracts per year in the five-year period 1980-1984; by way of comparison, during fiscal year 1984 alone, the Department entered into over 14.8 million contract actions.

The Conference's study of contractual indemnification found virtually no evidence of claims made on the basis of indemnification clauses or litigation over such claims. Although there is no indication that the government has incurred significant costs under contractual indemnity provisions in the 30 years that have passed since enactment of the National Defense Contracts Act in 1958 and the Price-Anderson Act in 1957, the space shuttle disaster and the Three Mile Island nuclear incident suggest that contingent liabilities under indemnity agreements are potentially costly.[2]

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[1] Examples are the National Defense Contracts Act, 50 U.S.C. §1431, as implemented by Executive Order 10789 (providing for indemnification under national defense contracts for unusually hazardous or nuclear risks); section 2354 of title 10 of the United States Code (providing for indemnification for unusually hazardous defense research and development activities); section 170 of the Atomic Energy Act, as amended by the Price-Anderson Act of 1957, 42 U.S.C. §2210(d) (providing indemnification for activities involving the risk of a substantial nuclear incident); the Federal Aviation Act, as amended, 49 U.S.C. §§1531 et seq. (providing for indemnification for risks where aircraft operations are necessary to carry out U.S. foreign policy); and the National Aeronautics and Space Act, as amended, 42 U.S.C. §2458b (providing for indemnification for damages related to the launch, operation or recovery of space vehicles).

[2] In 1982, the Comptroller General issued an opinion (B-201072, May 3, 1982; reconsid. 62 Comp. Gen. 361 (1983)) stating that to comply with the Federal Anti-Deficiency Act, 31 U.S.C. §1341, indemnity clauses in government contracts must

The Conference's study found that agencies generally do not believe that current practices and limits on indemnities discourage potential contractors from bidding. Federal agencies, with few exceptions, see little need for greater indemnification authority or for broad legislation that would extend indemnities to government contractors generally. However, this view is not shared by many federal contractors. They take the position that the decreasing availability of private insurance for a broad range of hazardous activities is greatly reducing the pool of bidders for contracts involving those activities in the absence of government indemnification. This legislative debate is beyond the scope of the present recommendation.

While the Conference takes no position on the current debate over proposals to expand agency authority to indemnify contractors for hazardous activities, mass injuries, or other special circumstances, the Conference does recommend the compilation of certain information that would provide a better basis in the future for ascertaining the need for and risks associated with broader indemnification.

This recommendation identifies several factors that agencies should consider when they determine whether to grant an indemnity clause to a particular contractor. It is appropriate for agencies to consider the scope of the indemnity proposed to be granted, including the proper mix of self-insurance, private insurance, and government indemnity. The factors listed should also be considered by Congress in deciding whether to grant new authority to an agency to indemnify its contractors.

Decisions to indemnify ordinarily require an assessment of whether the activity in question involves an unacceptable hazard or degree of risk. Sometimes the degree of risk is defined in terms of availability of insurance. Agencies regularly engaged in high-risk activities and able to grant indemnity clauses, such as the Department of Energy, Nuclear Regulatory Commission, or National Aeronautics and Space Administration, would normally have the resources to perform risk assessments. However, other agencies that confront these issues less frequently may not have adequate technical expertise to decide. It has been asserted that

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specify that the indemnity is available only to the extent of available authorized appropriations. This limitation, however, has limited impact where Congress has set maximum indemnity limits by statute, as in the Price-Anderson Act, or where no ceiling is set, as in the National Defense Contracts Act. The Price-Anderson Act reauthorization is pending as of the date of this recommendation.

there is often great uncertainty, and such decisions may be made inconsistently. The recommendation suggests referral and interagency cooperation as a way of meeting this problem.

RECOMMENDATION

1. **Identification of Agency Authority to Indemnify.** Each agency that has, and intends to exercise, the authority to indemnify any of its contractors against liability to third parties should set forth, in a policy statement or regulation, the agency's understanding of the extent and source of its authority to indemnify contractors. The agency should consult with the Department of Justice and the Office of Federal Procurement Policy in drafting the statement or regulation.

2. **Agency Decision Whether to Grant an Indemnity Clause.** Before deciding to grant an indemnity clause to a contractor, an agency should identify the public benefits expected to be gained by such a grant and should take into account:

(a) the nature and magnitude of the risks involved in the covered activities, including the danger inherent in the work to be performed, the adequacy of the state of the art to assess the inherent danger, the aggregate liability that could be incurred, when the liabilities might be incurred, and how current insurance policies would apply to such liabilities;

(b) the scope of the indemnity proposed to be granted;

(c) the source of funds that would be used to pay an award under the indemnity clause, including the possible application of the Federal Anti-Deficiency Act, and the impact, if any, that such an award will have on the programs of the agency or other units of the government;

(d) the incentives that either providing or denying an indemnification clause would give the agency for supervising contractual performance, so as to provide for maximum protection of the public from injury and to protect the government from unwarranted liability in light of the identifiable risks;

(e) the incentives that the contractor would have, assuming indemnification were granted, for performing under the contract in a safe and prudent manner;

(f) the incentives that the contractor would have, assuming indemnification were granted, to defend itself or to help defend the government in any subsequent litigation; and

(g) any effects, assuming indemnification were granted, on the ability or the willingness of the insurance industry to make available private insurance for the kinds of activities to which the indemnification would apply.

3. **The Need for More Information.** Each agency that has paid out any sum of money or received any claims for payment under a contractual obligation to indemnify a contractor, or on whose behalf such sums have been paid by the federal government, should report all such payments and claims to the Office of Federal Procurement Policy (OFPP) on an annual basis. The OFPP should periodically issue a report summarizing the information received. All such reports should be made available to the public except to the extent that release of any information included is prohibited by law. The OFPP should also obtain from each affected agency a list, updated periodically, of all existing contracts containing indemnity clauses.

4. **Contracting Office Expertise.** Where an agency is considering whether to grant an indemnity clause, but the contracting office does not have sufficient technical expertise to assess the degree of risk, the extent of the hazard, or the availability of insurance, these questions should be referred to an office of the agency that does have the requisite expertise to assist the contracting office in making such decisions. If the contracting agency as a whole lacks the expertise required to assess these matters adequately (for example, where unusual or newly emerging technological risks are involved), the agency should seek the assistance and cooperation of other agencies. Agencies with pertinent experience or knowledge should cooperate to make available to requesting agencies staff members whose experience in risk assessment may be helpful. It may be appropriate to create a small, highly-qualified risk assessment office to furnish or coordinate such assistance.

RECOMMENDATION 88-3:

THE FEDERAL RESERVE BOARD'S HANDLING OF APPLICATIONS UNDER THE BANK HOLDING COMPANY ACT

Among the Federal Reserve Board's (FED's) responsibilities is implementation of the Bank Holding Company Act (BHCA) (12 U.S.C. §§1841 *et seq.*). The BHCA's principal purposes are to ensure the safe and sound operation of bank holding companies (BHCs), to promote competition within the banking industry, and to separate banking from commerce.

Under the BHCA, the FED has also been authorized to determine the extent to which BHCs may engage in "non-banking" activities in the parent BHC and in non-bank subsidiaries. Because the banking industry has undergone rapid changes in the face of new technologies, the line between banking and other financial activities has been blurred.

Under Section 3 of the BHCA, the FED receives applications for the formation of or acquisition of banks by BHCs. The statutory factors which the Board must apply in acting on Section 3 applications include an evaluation of the competitive impact of the transaction, the convenience and needs of the community to be served, and the financial and managerial resources of the applicant.

Under Section 4(c)(8) of the Act, the FED receives applications by BHCs to acquire non-banking interests. Such applications are to be approved only when the activities involved are "closely related" to and a "proper incident" to banking. These questions have become of particular significance most recently in applications involving proposed securities and insurance activities of BHCs.

Applications under both sections are generally resolved without the need for an evidentiary hearing, although informal hearings and meetings are sometimes held. Both sections do, however, provide for an overall 91-day time limit on the FED's action on individual applications "beginning on the date of submission to the Board of the complete record on the application." The FED routinely processes well over 90 percent of the applications received by the FED within 60 days of "acceptance" of the application by the Reserve Bank (the Bank is permitted to request information, but otherwise must adhere to a short deadline in accepting the application and forwarding it to the FED). The FED's regulations specifically provide that, in every case in which an application has not been considered by the FED within 60 days of acceptance, the applicant will be notified and provided a written explanation for the delay.

In its regulations, the FED defines when the record on a particular application is complete for purposes of determining when the statutory 91-day period has begun. Under the FED's regulations, the 91-day period begins on the latest of four dates: 1) the date of acceptance of the application; 2) the last day of the public comment period (which is usually after acceptance of the application, and is the date upon which the 91-day period begins in the majority of cases); 3) the date of receipt of any relevant material information regarding the application; and 4) the date of completion of any hearing or other proceeding regarding the application.

Because the statute provides that the 91-day period does not begin until the complete record has been submitted to the FED, the courts have determined that the 91-day period may be tolled or retriggered after the close of the public comment period if new material information is submitted during the processing of the application. Examples of this type of information include comments or protests from interested parties, changes in the financial condition of the applicant, proposed efforts by the applicant to raise additional capital, or proposed divestiture plans to accommodate competitive problems.

Because there is always the possibility that submission of additional material information may toll or retrigger the 91-day period, the 91-day period is rendered rather uncertain in practice. Therefore, the Conference suggests that the FED's regulations on this issue ensure that there is a point in the application process at which the FED will declare that the applicant's file is deemed to be informationally complete, thus triggering the 91-day rule, unless additional information of a highly significant nature relating to the application is received.

The nature of the regulatory process established under the BHCA encourages a participatory approach to decisionmaking on the part of applicants and the FED. Various kinds of conditional order are used by the FED to tailor its regulatory decisions to the specific applicant before it. These regulatory conditions appear or are referenced in the FED's final order, and such conditions are subject to judicial review. Other decisions, however, reflect voluntary commitments made by the applicant. Such commitments often are the result of a decision by the applicant to expedite processing of a particular application by committing to resolve questions that might otherwise result in denial of the application. These commitments usually do not appear in the FED's order and, while reviewed by the Board in every case, are not subject to judicial review at the instance of the applicant.

The Conference believes that conditions and commitments are important regulatory tools used by the FED that, for the most part, add flexibility to and encourage efficiency in the consideration of applications to individual cases, providing a wide range of regulatory choices between unconditional approval and complete denial of an application.

RECOMMENDATION

The Board of Governors of the Federal Reserve System should take the following actions with respect to the FED's handling of applications under the Bank Holding Company Act.

1. **Clarification of the 91-day rule.** When acting on such applications, the Federal Reserve Board should by regulation provide that only receipt of information of a highly significant nature pertaining to the application will be deemed to warrant reopening an applicant's file, thereby deferring the date by which the Fed must act finally on the application.

2. **Conditions and Voluntary Commitments.** Conditions established by the FED regarding applications and voluntary commitments offered by applicants should be unambiguous and reasonably related to an articulated policy of the Federal Reserve Board. Voluntary commitments, when offered by applicants, should, consistent with the Freedom of Information Act, ordinarily be made part of final orders of the Board. Moreover, the Board should, from time to time, summarize the thrust of these commitments and publish and disseminate these summaries.

RECOMMENDATION 88-4:

DEFERRED TAXATION FOR CONFLICT-OF-INTEREST DIVESTITURES

Individuals appointed to government positions are sometimes required to divest themselves of property to satisfy conflict-of-interest requirements, such as the prohibition in 18 U.S.C. § 208 on participation in matters affecting one's financial interest. In other instances, divestiture of property by such appointees would be simpler and serve conflict-of-interest purposes better than the establishment of qualified blind trusts or subsequent and sometimes frequent recusals by an official from participation in particular decisions. In addition, persons serving in the government occasionally are required to divest themselves of property before accepting a new position or as a condition to participating in a particular matter.

Divestiture of property to avoid conflicts of interest will often result, under current law, in financial losses in the form of taxation of the gains realized as a result of divestiture. The Administrative Conference believes that this tax burden is a disincentive to individuals who would otherwise accept a federal appointment, and in the case of present officials, an unnecessary burden resulting from their performance of official responsibilities. The adverse effects of this disincentive to government service are most acute with respect to the most senior positions involving major policymaking roles. Failure to obtain the best people for those positions, or the frequent recusals of people in those positions, may have serious adverse consequences on both the individuals involved and the government.

The Conference accordingly recommends that Congress amend the Internal Revenue Code to permit deferred taxation of gains for presidential appointees subject to Senate confirmation and other individuals entering the government to accept high level executive branch positions, whenever they are requested or ordered by an appropriate authority to divest themselves of property to avoid actual or potential conflicts of interests. The Conference also recommends that Congress consider amending the Code to extend similar tax treatment to persons serving in the executive branch.[1]

The Conference proposes that this defined class of persons be permitted to sell such property and to place the proceeds in a neutral investment vehicle and maintain their original basis in the divested property. Taxation would not be eliminated by this proposal, but only postponed until the individual ultimately disposes of the proceeds of a reinvestment vehicle. The Conference also suggests specific factors and other matters to be taken into account in amending the Code to accomplish these purposes.

The Conference believes that revenue impact of the recommendation will be minimal considering the narrow class of persons that would be eligible for tax deferral.

RECOMMENDATION

1. Congress should amend the Internal Revenue Code to permit presidential appointees who are subject to Senate confirmation and other officials entering the government to accept high level executive branch appointments, to divest property, such as securities, and reinvest the proceeds in a neutral investment vehicle and thereby defer realization of taxable gains.

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[1] This recommendation is limited to executive branch appointees and employees because the Conference by statute is limited to studying and recommending improvements to administrative procedure, 5 U.S.C. §§ 571-576. The Conference, therefore, takes no position on whether or not similar tax treatment should be accorded to officers of the judicial branch.

2. Such amendment should take into account the following factors:

(a) the need to assure that the divestiture is undertaken to avoid actual or potential conflicts of interests, by conditioning the deferral on an order or request of the President (or his delegate such as the White House Counsel or the Director of the Office of Government Ethics);

(b) the need for divestiture by spouses, dependent children, and others whose assets may be imputed to the federal official for conflict-of-interest purposes, by making deferral available to them also; and

(c) the need to assure that the reinvestment vehicle avoids conflicts of interests with respect to the position to be held, by having the person ordering or requesting divestiture approve the vehicle.

3. Congress should consider whether the amendment should contain provisions dealing with the following matters:

(a) a minimum period of required government service after divestiture to qualify for deferral;

(b) requiring the appointee to defer gains or losses for all property within the class of divested property (*e.g.*, all energy stock), in order to prohibit the appointee from recognizing losses and deferring gains;

(c) permitting the appointee a second deferral on leaving government service (or within a brief period of time thereafter) if the appointee chooses to dispose of the neutral investment held during government service in order to make another investment.

4. The Conference recognizes that other persons serving in the executive branch may be ordered or requested to divest specific property in order for them to perform their duties free of actual or potential conflicts of interest, and believes that Congress should also consider, at the appropriate time, whether to extend similar tax treatment to them.

RECOMMENDATION 88-5:

AGENCY USE OF SETTLEMENT JUDGES

Many cases over which administrative law judges, administrative judges, and other agency hearing officers preside do not involve broad regulatory issues and are often appropriately resolved by settlement. Following in the footsteps of several innovative federal judges,[1] some administrative agencies have begun to provide additional mechanisms for resolving these cases. The Federal Energy Regulatory Commission and the Occupational Safety and Health Review Commission have used a "settlement judge"--not the presiding judge in the case--to work with parties to explore possibilities for consensual resolution. Other alternatives that agencies have used include prehearing conferences and summary procedures,[2] and more recently, minitrials, mediation and binding and nonbinding arbitration.[3]

Agency prehearing conferences have historically been utilized as a means for either settling an entire case or narrowing the issues. Today, some presiding judges are exceptionally effective at using these conferences to promote settlement without overstepping bounds of propriety. Still, while the presiding judge may be the ideal person to suggest that the parties talk settlement in a reasonable manner, he or she often cannot help the parties' explorations in any comprehensive way without risking the appearance of impropriety. In broad classes of cases, a separate settlement judge, not so limited, can exercise greater settlement-inducing authority than the presiding judge.

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[1] In addition to settlement conferences, courts have engaged in broad and growing use of other means for facilitating an early disposition of a case including arbitration, special masters, mediators, and the use of summary jury trials. Rule 16(c) of the Federal Rules of Civil Procedure was amended in 1983 to provide that settlement and "extrajudicial procedures" for resolving disputes are desirable and may be a subject at pretrial conferences, while subsection (f) of the rule provides for sanctions for failure to appear at, to be prepared for, and "to participate in good faith" at such conferences.

[2] *See* ACUS Recommendation 70-4(1) (urging presiding officers to hold prehearing conferences on own motion or at the request of the parties) and Recommendation 70-3 (summary decision).

[3] *See* ACUS Recommendation 86-3 (alternative means of dispute resolution) and Recommendation 87-11 (alternative means of dispute resolution in government contract disputes). In both recommendations, use of settlement judges is specifically recommended, 86-3(D), 87-11(d). *See also* Recommendation 72-4(D) (settlement of ratemaking cases).

The Conference does not intend to suggest that use of settlement judges is a dispute resolution method that is necessarily better or worse than adjudication, arbitration, minitrials, mediation by staff personnel or nongovernment mediators, or settlement by the presiding judge; parties should retain maximum flexibility to use the best procedure for their case. The best solution of all is to settle *before* an action has been instituted, and agencies should also do far more to instill consensual methods of dispute resolution into investigatory, pre-enforcement, and other stages. The settlement judge technique, nonetheless, is a useful means of facilitating settlements that, in appropriate adjudications, may be of great value.

The settlement judge can command a degree of deference similar to that of the presiding judge without the need to observe all of the commands that establish and maintain impartiality. A separate settlement judge, once appointed, can engage in ex parte and off-the-record conversations, frank assessments of the merits, and other techniques to aid settlement that the presiding judge is less free to use. The settlement judge is generally knowledgeable about the kind of case and the parties' interests, and is in a position to lend structure to the negotiations, control their pace, reduce the adversarial nature of the process, and help the parties to assess objectively both the strengths and weaknesses of the case and to find reasoned solutions. The settlement judge is familiar with how the presiding judge is likely to handle such cases, how much time and effort they take, how evidence is weighed, and what kind of a reception the legal and factual issues will be given in light of agency precedent and policy. The settlement judge, who carries a judge's power and authority, may greatly reduce the scope of parties' disagreements over likely outcomes. Parties also are less likely to be skeptical about the informal settlement judge process and more likely to view this device as a legitimate and potentially valuable means of reaching an enforceable, legally defensible settlement.

Several other advantages may accrue. Initiating the settlement judge technique may be an excellent way for agencies to introduce the idea of settlement in proceedings in which it is not now frequently pursued but which the presence of other factors seems to make apt candidates. In such circumstances, an agency could make special efforts to make the technique available in the interest of breaking the adversarial mold, perhaps preceded by seminars or other devices to permit its presiding judges to study mediation, negotiation and other settlement-inducing techniques. In individual cases, use of a settlement judge might lead the parties to turn to mediation or other non-adjudicatory means of pursuing a settlement agreement. Presiding judges' experiences as settlement judges, and possible enhanced expertise as mediators, should help them in resolving later cases.

Settlement judges are not a panacea, and their use must take into account caseloads, possible abuses in extreme cases, and likelihood of success. The very potency of the judicial office means that it must be carefully employed to avoid abuse. Even so, the Conference sees great merit in the settlement judge technique and urges that it receive much wider consideration and application as a means of actually settling matters, or convincing the parties to undertake other consensual dispute resolution methods.

These recommendations suggest procedures for using the settlement judge as a final effort to obviate formal proceedings, as well as guidelines that seek to increase potential gains in efficiency while minimizing possible abuses that may result from a greater reliance on settlement in agencies' adjudicatory proceedings.

RECOMMENDATION

A. Encouraging Use of Settlement Judges

1. As part of efforts to encourage use of consensual means of dispute resolution, federal agencies that decide cases presided over by administrative law judges, administrative judges, or other hearing officers should encourage and facilitate settlement of adjudicatory proceedings by the

voluntary use of settlement judges and other consensual methods.

2. Agency offices of administrative law judges, boards of contract appeals, and other hearing offices should adopt rules for appropriate use of settlement judges.

3. In urging regularized and amplified utilization of settlement judges, the Administrative Conference has no intention of discouraging reliance on other methods of dispute resolution without recourse to formal procedures. In many instances, cases of the types deemed suitable for reference to a settlement judge (paragraph B, below) can and should be settled at preliminary stages of disagreement. At times, moreover, early recourse to mediation or arbitration (where authorized) may be appropriate.[4] The Administrative Conference urges constant attention to settlement possibilities long before a controversy has reached the docket of a trial judge.

B. Appropriate Cases. In general, the agency use of settlement judges may be appropriate where one, and particularly more than one, of the following factors appear:

1. Crowded dockets with relatively few cases being settled.

2. Presence of a large proportion of factual issues that are not of major precedential importance and do not raise broad policy or legal issues, particularly where the facts are undisputed and the primary issues concern the interpretation or characterization of such facts.

3. Remedies susceptible to gradation and, thus, to compromise. Examples are money claims, rates,[5] and degrees of restrictions or activity.

C. Administrative Issues

1. The chief judge should retain discretion in assigning settlement judges on the basis of the situations, issues, judges'

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[4] *See* Recommendation 86-3 and 87-11, *id.*

[5] *See* Recommendation 72-4, *supra*, note 3.

aptitudes and personalities, and so forth. He should also remain free to refuse to appoint a settlement judge.

2. The agency head should ordinarily not suggest use of a settlement judge, since he is much less likely to know when a particular case is suitable for settlement and much more likely to desire a case to be settled to avoid having to decide it.

3. Given the workload of presiding judges and possible limited availability for appointment as a settlement judge, agencies should use, as an alternative source of settlement judges, currently retired ALJs who have notified the Office of Personnel Management that they would accept temporary appointment (pursuant to 5 U.S.C. § 3323(b), enacted in 1984), retired administrative judges or hearing officers, or active hearing officers from another agency.

4. Agency presiding judges, and especially chief judges, should regularly review their dockets to identify cases where use of settlement judges may be useful, and consult regularly with experienced mediators to locate cases ripe for settlement.

5. Agencies should give attention to offering training in negotiation, mediation, and other consensual dispute resolution skills to administrative law judges, administrative judges, and other hearing officers. Training courses or seminars should be developed by agencies jointly or in cooperation with the Administrative Conference, Federal Mediation and Conciliation Service, Board of Contract Appeals Judges Association, American Bar Association, or other professional organizations. Agencies should also work with other interested groups to sponsor similar programs or outreach sessions for representatives who regularly appear in agency proceedings.

D. Procedures. Agency regulations or guidelines implementing the use of settlement judges should consider the following:

1. Suggesting use of a settlement judge

(a) The suggestion that a settlement judge be consulted may be made to the agency's chief judge by any party or by the presiding judge (although the agency head's invocation of the technique should be restrained (see C.2, above)). Because it will usually be difficult to predict at what points in the prehearing process settlement will be possible, the presiding judge and the parties should be free to request appointment of a settlement judge at any time. Any party or the presiding judge may veto such a suggestion.

(b) The chief judge should seek to ensure that all parties who appear *pro se* consent knowingly and voluntarily before he decides to invoke the aid of a settlement judge.

2. Appointment

(a) When appointing a settlement judge, the chief judge should issue an order specifying the length of time for such negotiations and confining the scope of any settlement negotiations to specified issues.

(b) When a settlement judge is appointed, the presiding judge may suspend discovery or other proceedings during the time the matter is assigned to the settlement judge.

(c) If settlement negotiations are terminated, the chief judge may subsequently appoint a settlement judge in the same proceeding to conduct further negotiations.

(d) To ensure that proceedings are not unnecessarily interrupted, agency regulations or guidelines should provide that any decision concerning the appointment of a settlement judge or termination of settlement negotiations is not subject to review or rehearing.

3. Conduct of negotiations

(a) The regulations should afford the settlement judge broad authority to:

(1) confer with the parties on the subject of whole or partial settlement,

(2) suggest privately to a party's representative what concessions be considered by the party,

(3) assess privately with each representative the reasonableness of the party's case or settlement position,

(4) facilitate communications between the parties,

(5) mediate.

(6) seek resolution of as many issues in the case as is feasible, and

(7) recommend use of minitrials, mediation, factfinding, or other consensual resolution means, and, if the parties genuinely wish some method of presenting evidence in a settlement context or having the dispute mediated, the settlement judge should be free to refer them to a separate minitrial or mediation process.

(b) To increase the likelihood of settlement, the regulations should:

(1) provide that the settlement judge may recommend that the representative who is expected to try the case be present at a settlement conference and that the parties, or their agents having full settlement authority, be present.

(2) set forth specific guidelines for conducting settlement conferences (including by telephone) where appropriate.

(3) exhort all parties and their representatives to be candid with the settlement judge so that he may properly guide settlement discussions.

(4) provide the settlement judge with flexibility to impose any additional requirements proper to expedite resolution of the case.

(c) The settlement judge should, within days after appointment, meet or talk with the parties together and (usually) separately to determine what obstructs settlement. Proceedings before a settlement judge should not ordinarily be lengthy or elaborate.

4. Confidentiality

(a) To encourage the candor often necessary to achieve a settlement, the regulations should provide that no evidence of statements or conduct by parties, counsel or settlement judge in the settlement proceedings shall be admissible in any subsequent hearing, except by stipulation of the parties. The regulations should further provide that documents disclosed in a settlement process may not be used in litigation unless obtained by appropriate discovery or subpoena. Agencies should provide sanctions against any violators.

(b) The regulations should prohibit the settlement judge from discussing the merits of the case with the presiding judge or any other person[6] and preclude the settlement judge from being called as a witness in any hearing of the case.

5. Settlement and reports

(a) At the conclusion of the settlement procedures, either the parties should tell the presiding judge that they have settled, or the settlement judge should advise the trial judge, without elaboration, that settlement has not been reached. The report should not attribute any view to any party or assess any positions taken. The agency's regulations should describe the method by which the presiding judge is advised that settlement has not been reached.

(b) To protect against unnecessary delay, the settlement judge's first report should be made within a specified period after appointment. The agency head or chief judge should be authorized to order additional reports at any time.

(c) In reporting, the settlement judge may recommend the termination or continuation of settlement negotiations.

(d) A settlement arrived at with the help of a settlement judge should be treated like any other settlement.

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[6] This should not prevent judges within the same office from engaging in discussions of settlement or mediation techniques that may aid the settlement judge in resolving particular cases and assist in a judge's professional development.

RECOMMENDATION 88-6:

JUDICIAL REVIEW OF PRELIMINARY CHALLENGES TO AGENCY ACTION

The Administrative Conference of the United States has long had an interest in forum allocation in administrative cases. In Recommendation No. 75-3, "The Choice of Forum for Judicial Review of Administrative Action" (1975), the Conference stated criteria for determining the appropriate judicial forum for the review of final administrative action. The Recommendation urged that agency actions taken on the basis of a formal evidentiary record should normally be directly reviewable by courts of appeals, and that rules and other informal orders issued by agencies whose formal orders are subject to review in the courts of appeals should be reviewable by those same courts.

Building upon the principles underlying that recommendation, the Conference now addresses the proper forum for judicial review where an agency has issued no final order, but agency action (or inaction) is nevertheless considered reviewable by a court*. For example, a party may allege that agency action has been "unlawfully withheld or unreasonably delayed" within the meaning of 5 U.S.C. §706. What level of court--trial or appellate--should have jurisdiction over such a preliminary challenge? Most direct review statutes do not specifically address this question, and difficult jurisdictional questions have arisen as a result.

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*The Administrative Conference takes no position in this recommendation on whether and under what circumstances such preliminary actions should be deemed judicially reviewable before issuance of a final order by an agency.

The leading decision on this subject is *Telecommunications Research and Action Center v. FCC*, 750 F.2d 70 (D.C. Cir. 1984) (*TRAC*), a case involving a challenge to allegedly unreasonable agency delay. In *TRAC*, the United States Court of Appeals for the District of Columbia Circuit concluded that when the relevant statute assigns review of final agency action (when and if it occurs) exclusively to the court of appeals, then a preliminary challenge also will be subject to exclusive appellate review so long as relief in relation to it might affect the court's ultimate jurisdiction. Based on a court's authority to issue writs in aid of its jurisdiction under the All Writs Act, *TRAC*'s holding strongly favors consolidating preliminary challenges in the courts of appeals even when the agency's organic statute does not settle the point.

However, some confusion has followed the *TRAC* decision. Subsequent opinions have grappled at length with the question of what "might affect" the court's jurisdiction and, in some cases, have carved out exceptions to the *TRAC* doctrine. Some district courts, for example, have distinguished certain constitutional claims, for which they have upheld district court jurisdiction.

In addition, some problems have remained because *TRAC* cannot readily be applied to situations in which the agency's final action might take different forms, with different jurisdictional consequences. For example, in some cases the Occupational Safety and Health Administration may decide to issue "standards", which are reviewable in the courts of appeals, or "regulations", which are reviewable in district court. Jurisdictional uncertainty can also occur in preliminary challenges involving Food and Drug Administration approval of new drug applications under the Food, Drug and Cosmetic Act, 21 U.S.C. §355. When the FDA refuses to approve an application, the statute authorizes the applicant to appeal directly to the courts of appeals; this special review provision does not apply, however, to parties challenging FDA approval of a new drug application, who thus must proceed in district court. In cases like these, the *TRAC* rule may require courts to make premature jurisdictional analyses based on speculation about the nature of the action the agency may ultimately take in order to determine whether they can hear the preliminary challenge.

The Conference believes that there is a need for greater clarity in this area. Unless Congress has reason to direct otherwise in a specific statute, jurisdiction over all such preliminary challenges should follow the principle of *TRAC*. The requirement that preliminary challenges be heard exclusively by the court that will ultimately review final agency action may influence a litigator's decision whether to raise an issue preliminarily and thus discourage the bringing of preliminary review proceedings that have little merit but offer some potential for creating delay. In addition, the courts that review final agency action may be more familiar with the substantive programs administered by an agency, and thus better able to evaluate the issues raised in preliminary challenges. To avoid further confusion over proper jurisdiction, the *TRAC* rule should be interpreted to include all cases in which final action would be reviewable in the courts of appeals, and the exceptions that have been carved out by the district courts should be rejected. Where jurisdiction over the final action is unclear, however, preliminary challenges should be cognizable in either the district courts or the courts of appeals.

Some special consideration may be necessary where preliminary challenges involve allegedly unlawful delay by an agency. For these challenges, by definition, time is generally of the essence; moreover, they usually do not require elaborate analysis of the relevant facts or applicable law. Frequently these claims may be resolved more easily and expeditiously through the use of simpler or less formal approaches than through the ordinary course of briefing and oral argument. The courts of appeals should develop techniques for dealing with these cases promptly and practically when they arise. While the most effective measures may vary depending upon the procedural rules applicable in individual courts, possible approaches might include rules permitting, in appropriate cases, decision on the briefs without oral argument, the filing of petitioners' briefs simultaneously with the notice of appeal, expedited calendaring of delay cases, informal status or settlement conferences involving a single judge, and, where the record may require expansion through factfinding, prompt assignment to a district court, magistrate, or other official for that purpose.

Accordingly, the Conference offers the following recommendation.

RECOMMENDATION

1. In considering legislation that would assign jurisdiction to review agency action to either district courts or courts of appeals, Congress should

(a) follow the principles stated in ACUS Recommendation 75-3, *The Choice of Forum for Judicial Review of Agency Action*; and

(b) take special care to consider where preliminary challenges to agency decisionmaking should be brought, specifying whether the district courts or the courts of appeals or both have jurisdiction over such challenges. As a general rule, jurisdiction over reviewable preliminary challenges should be assigned to the forum that would have jurisdiction if an appeal were taken from final agency action growing out of the proceeding.

(c) provide that when the proper forum for judicial review of final agency action may be either the district courts or the courts of appeals, depending upon matters such as the form the agency's action will eventually take or the outcome of the proceeding, any of the courts that might have jurisdiction over final agency action should have jurisdiction over reviewable challenges to the agency's preliminary action (or inaction).

2. In the absence of Congressional direction, the principles identified in paragraph 1(b) and (c) of this recommendation should govern the choice of forum for otherwise reviewable preliminary challenges to agency action.

3. Where jurisdiction over claims involving unlawful delay by an agency lies in the courts of appeals, those courts should assure that their procedures provide adequately for prompt and efficient disposition of such claims.

RECOMMENDATION 88-7:

VALUATION OF HUMAN LIFE IN REGULATORY DECISIONMAKING

Regulations intended to lessen risks of accidents and illness ordinarily impose compliance costs on regulated entities and on rulemaking agencies. In return, society gains numerous benefits, most notably the avoidance of fatalities, injuries and disease, and in some instances a reduction in property damage. Promulgation of such regulations is a multi-faceted process, and this recommendation addresses one set of issues frequently encountered in agency decisionmaking -- the valuation of human life.

Agencies often make reasoned estimates of the reduction in fatalities likely to follow implementation of a particular regulation, or of alternative regulations. It is rarely if ever possible to eliminate risk altogether, and it is nearly always the case that greater risk reduction raises compliance costs. Faced with such situations, agencies cannot avoid placing a value -- either explicitly or implicitly -- on the societal benefits of risk reduction. Although similar issues are obviously involved when agencies seek to evaluate the benefit of avoiding illnesses or injuries, this recommendation is limited to agency practices and constraints in benefits valuation when the benefit at issue is future lives saved.

Placement of a dollar value on human life is controversial and complex, and a wide array of approaches may be employed. A broad range of dollar values per life saved can be observed in regulatory outcomes across programs and departments. In part, this reflects differing views about what explicit value is suitable for a given type of hazard, and in part it reflects judgments that, for reasons of policy or legal constraints, decisions should take no account of the value of life implicit in those decisions. Some agencies reject all explicit efforts to place a monetary value on human life, while others routinely build such estimates into their regulatory proposals. This diversity can be sharp even within the same department. Those agencies that are willing to utilize explicit normative benchmarks for the value of life appear to be moving toward reliance on the same basic estimation technique, generally referred to as "willingness-to-pay." This technique is premised on the assumption that by examination of marketplace behavior, one can roughly ascertain how much individuals would be willing to pay in order to reduce the probability of death from a particular hazard or cause, or how much they would require in the form of salary increases or other payments to be willing to accept the increased probability. While willingness-to-pay provides the most inclusive analysis currently available for evaluating the benefits derived from regulatory reduction of fatalities, it falls far short of an ideal process and can produce results that are misleading because the analysis often fails to take into account all relevant variables.

The Conference recognizes the rudimentary state of knowledge on this issue, and realizes that both methodologies and results are likely to continue to vary among agencies. In this environment, however, it would be useful for agencies to take measures that would reveal publicly the processes through which they have determined the valuation of life incorporated in policy decisions.[1] Such a procedure would provide useful clarification and exposition of the unavoidable trade-offs in regulating hazards, and would also assist in drawing attention to those hazards where further protection may be feasible at acceptable cost.

In this way, agency practice may also be measured against developments in the valuation techniques and evaluated for consistency with other agencies as well as with other regulations in the same agency. The Office of Management and Budget (OMB), in its oversight of executive branch regulatory activities, could facilitate consistency by providing a central clearinghouse for research and information on life valuation issues. OMB should also assist agencies by updating its guidance concerning discount rates used by agencies in deriving present value equivalents of future effects. The current government-wide general guidance on discounting is contained in OMB Circular A-94 which has not been updated since 1972.

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[1] In 1979, the Conference made a similar recommendation about cost-benefit analyses, Recommendation 79-4, *Public Disclosure Concerning the Use of Cost-Benefit and Similar Analyses in Regulation*, 1 C.F.R. §305.79-4 (1988).

RECOMMENDATION

1. When an agency adopts a regulation that is intended to reduce the risk to human life, based on a judgment that the associated compliance costs are justified, the agency should disclose the dollar value per statistical life used for the purposes of that determination. Such statements and disclosures should also set forth the human life valuation implications of alternative levels of regulatory stringency considered by the agency. Exceptions to this principle may be appropriate where empirical information about either the costs or benefits of the regulation is highly conjectural, or where the benefits include values which cannot be quantified in market terms, *e.g.*, aesthetic gains. In such cases, agencies should explain the nature and degree of imprecision in the valuation process so that the public will not be misled. When an agency declines to adopt a regulation due to these considerations, it should provide similar information.

2. In implementing paragraph 1, agencies that develop and use methodologies for placing a monetary value on human life should recognize that there remain substantial limitations of current methodology to incorporate all the variables that affect societal valuations of human life. An agency should explain the factors included or considered in its valuation. The agency also should explain how it weighs such factors.

3. Whenever agencies choose to discount costs and benefits in implementing paragraph 1, they should clearly and fully disclose what rates they are using, the methodology that generated those rates, and the sensitivity of outcomes to the particular rates applied. The Office of Management and Budget (OMB) should revise its guidance concerning the use of a discount rate in the valuation of costs and benefits to reflect recent learning on the subject, either through updating OMB Circular A-94 or by other means. Such guidance should articulate the various methods by

which a discount rate can be derived and the scope of subjects to which it can be applied.

4. OMB should serve federal agencies as a central clearinghouse for research and information on life valuation issues. To this end, OMB should continue and expand its discussion of agency practices in the life valuation area, initiated in the 1987-88 edition of the annual Regulatory Program of the United States Government.

RECOMMENDATION 88-8:

RESOLUTION OF CLAIMS AGAINST SAVINGS RECEIVERSHIPS

When a federally insured savings and loan institution ("thrift") fails, the Federal Home Loan Bank Board (FHLBB) exercises overall regulatory control. The Federal Savings and Loan Insurance Corporation (FSLIC), under the direction of the FHLBB, ordinarily acts as receiver for federally insured thrifts, and, in that capacity, must pay the valid credit obligations of the failed thrift. In the process of accepting, settling or rejecting a diverse and complex range of creditor claims, the FSLIC attempts to resolve disputes informally. If this cannot be done, claimants may resort to an adjudicative process. The locus of this adjudication --agency or court-- and its elements are the concerns of this recommendation.

Exclusivity of the Agency Adjudication Process. The FHLBB and its sister agency, the FSLIC, have asserted exclusive jurisdiction to adjudicate creditor claims against thrift receiverships. To establish and enforce its asserted power as receiver to adjudicate creditor claims, the FSLIC has adopted the practice of seeking to have claims litigation that has been initiated in state courts removed to the federal courts, where the FSLIC then moves for dismissal for want of subject matter jurisdiction. The agency has sometimes moved to override court judgments granted to creditors that were entered before a thrift was placed in receivership.

The FSLIC's argument is that, as receiver, it has been vested with exclusive power to determine the validity of creditor claims, and that the jurisdiction of the courts to make independent determinations has been precluded. It is further argued by the

FHLBB and FSLIC that their final administrative determinations are subject, not to *de novo* judicial review, but only to the limited judicial review provided under the Administrative Procedure Act. This agency position has become known as the *Hudspeth* doctrine, after the Fifth Circuit decision in which it was first accepted (*North Mississippi Savings and Loan Association v. Hudspeth*, 756 F.2d 1096 (5th Cir. 1985)). But other courts have declined to follow *Hudspeth*. See, e.g., *Morrison-Knudsen Co., Inc. v. CHG International, Inc.*, 811 F.2d 1209 (9th Cir. 1987), holding that the FSLIC has no statutory authority to adjudicate claims to the exclusion of the courts. The U.S. Supreme Court has granted *certioriari* to resolve the differences. See *Coit Independence Joint Venture v. FirstSouth, F.A*, 829 F.2d 563 (5th Cir. 1987), *cert. granted*, 108 S. Ct. 1105 (1988).

Because of the considerable adjudicatory power that the *Hudspeth* doctrine potentially grants to the FSLIC, the doctrine has provoked controversy concerning the fairness, efficiency, and legal and constitutional validity of the administrative procedures. In fact, the position of the Solicitor General in its brief for the Government in the *Coit* case does not endorse the FHLBB's argument that it is statutorily empowered to "adjudicate" these claims. The Solicitor General maintains that, while Congress could have provided for administrative adjudication in this context, it has simply (and appropriately) provided for a claims review step in the process that must be exhausted by claimants before they seek judicial resolution of claims.

The Conference takes no position on the statutory and constitutional power of the FHLBB to resolve these claims. Unless the Supreme Court finds administrative adjudication in this context to be constitutionally impermissible, Congress should examine the need for agency adjudication of such claims, as an alternative to, or at least a required prelude to, *de novo* resolution of such claims in state and federal courts. For this reason, the Conference has examined the fairness and efficiency of the current administrative procedure for determining creditor claims against thrift receiverships.

Current Claims Procedures. Claims against failed thrifts are institutionally and procedurally separated at the FSLIC. Those made by insured depositors on the one hand, and uninsured depositors and other creditors on the other, are handled by separate divisions within the FSLIC. Although many claims are resolved at the division level (so-called "receiver's determinations"), rejected claimants may seek administrative review by the Adjudication Division of the FHLBB's Office of General Counsel, with final administrative review by the Board itself in complex cases. Though the case law is unsettled, *de novo* judicial review has been allowed in the case of insured depositor claims and, under the *Hudspeth* decision, limited judicial review under the Administrative Procedure Act was contemplated in the case of non-insured and general creditor claims.

Need for Congressional Attention. As thrift receiverships proliferate, the Conference urges Congress to consider whether it is more appropriate for disputes over claims filed against such receiverships to be decided by the FHLBB, or whether it is better to leave them to *de novo* resolution in state and federal courts -- with or without a prior administrative claims review step at the FHLBB.

If Congress does determine that an administrative adjudication process (coupled with appropriate judicial review) is the preferable approach, it should clarify the FHLBB's statutory authority. It should provide for an adjudicative system that makes clear that claimants have an opportunity to have their claims heard by adjudicators who are completely independent of other offices of the FHLBB or FSLIC, which may be perceived to have a financial interest in the outcome of such claims. To that end, a bifurcated hearing process should be established, offering claimants who can demonstrate that an issue of material fact is genuinely presented an opportunity for an on-the-record APA hearing presided over by an administrative law judge. An alternative, simplified procedure should be authorized for other cases or where parties agree to use it.

The FHLBB's current program of adjudicating claims against receiverships requires two additional improvements. First, final rules of practice need to be issued,[1] and time limits should be established. Second, the agency should refrain from attempting to override prereceivership judgments entered in federal or state courts.

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[1] On November 8, 1985 the FHLBB published proposed rules governing its claims adjudication process (see 50 Fed. Reg. 48970). On April 21, 1988 the FHLBB published interim procedures pending the adoption of final regulations, giving notice that the interim procedures that have been in effect in practice since July 1, 1986 will remain in effect pending the adoption of final regulations. See 53 Fed. Reg. 13105.

RECOMMENDATION

1. Congress should determine whether disputes over claims filed against thrift receiverships are better decided by the Federal Home Loan Bank Board (FHLBB) in an administrative adjudication process (coupled with judicial review) or by the judiciary through *de novo* resolution in state or federal courts (with or without a prior administrative claims review step at the FHLBB).[2]

2. If Congress does determine that an administrative adjudication process is the more desirable approach, it should clarify the FHLBB's statutory authority by providing for an FHLBB adjudicative process along the lines set forth below:

a) A bifurcated process should be established for adjudicating claimant appeals from determinations of thrift receivers. Where the claimant affirmatively demonstrates that an issue of material fact is genuinely presented, the FHLBB should offer an opportunity for an on-the-record APA hearing, presided over by an administrative law judge. In all other cases, or where the parties voluntarily agree, the FHLBB should be authorized to use simplified, less formal procedures, presided over by persons who need not be ALJs but who should be institutionally separate from the receiver.[3] All parties, including receivers, should be encouraged to engage in alternative means of dispute resolution.[4]

b) Final FHLBB decisions on such claims should be based on the administrative record and subject to direct judicial review in accordance with the principles stated in ACUS

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[2] The Conference, at this time, does not intend to express an opinion on which of these alternatives is preferable.

[3] See ACUS Statement, "Dispute Resolution Procedure in Reparations and Similar Cases", 1 CFR 310.13 (1988).

[4] See ACUS Recommendation 86-3, "Agencies' Use of Alternative Means of Dispute Resolution," 1 CFR 305.86-3 (1988).

Recommendation 75-3 ("The Choice of Forum for Judicial Review of Administrative Action").

3. The FHLBB should publish, after a notice-and-comment rulemaking procedure, final rules setting forth its rules of practice for claims determinations. The rules should provide for strict, albeit reasonable, time limits[5] applicable not only to claimants but also to receivers and their agents.

4. The FHLBB (and FSLIC as receiver) should not override prereceivership judgments entered in federal and state courts. The agencies' power to adjudicate claims should not encompass judgments in favor of creditors that have been entered by a court of competent jurisdiction before the thrift was placed in receivership. The FSLIC as receiver should either acquiesce in these judgments or pursue post-trial remedies.

5. Congress should include in any legislation responsive to this recommendation a requirement that the FHLBB adopt appropriate regulations and policies as set out in paragraphs 3 and 4.

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[5] See ACUS Recommendation 78-3, "Time Limits on Agency Action," 1 CFR 305.78-3 (1988).

RECOMMENDATION 88-9: PRESIDENTIAL REVIEW OF AGENCY RULEMAKING

Federal regulation has grown in both scope and complexity in recent decades. Among its wide variety of national goals are: ensuring competitive markets, spurring economic growth, checking inflation, reducing unemployment, protecting national security, assuring equal opportunity, increasing social security, protecting the environment, ensuring safety, and improving energy sufficiency. Policies implementing these goals compete for scarce resources and sometimes conflict with one another. Thus, a central task of modern democratic government is to make wise choices among the courses of action that pursue one or more of these goals.

While Congress establishes the goals, it seldom legislates the details of every action taken in pursuit of these goals or makes the balancing choices that these decisions require. It has assigned this task to the regulatory agencies. Each regulatory agency, however, usually is given a set of primary goals, without specific regard for whether proposed actions in pursuit of those goals might conflict with the pursuit of other goals by other agencies. An effective mechanism is needed to coordinate agency decisions with the judgments of officials having a broader perspective, such as the President and Congress.[1]

Some form of presidential review of agency rulemaking has been the practice since at least 1971. Like its predecessors, the current program is established by presidential executive order.[2] The responsible officer (the Administrator, Office of Information and Regulatory Affairs, in the Office of Management and Budget) is appointed by the President, subject to Senate confirmation.

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[1] The need for greater coordination of federal regulation was recognized in 1979 by the American Bar Association's Commission on Law and the Economy.

The Conference believes that there is sufficient experience under these executive orders to warrant continuing such review with certain guidelines as to its implementation. The Recommendation below sets forth standards that should be followed whether review is governed by executive order or by a general statute. It also assumes that the President has the authority to enunciate principles to guide agency rulemaking, even though the programmatic responsibilities are by statute delegated to agencies. In addressing the presidential review process, the Conference recognizes that some of the issues are analogous to congressional involvement in agency rulemaking, but it does not address this latter subject at this time.

RECOMMENDATION

The Conference recommends that the following principles should guide any program of presidential review[3] of agency rulemaking:

1. *General Applicability.* Presidential review should apply generally to federal rulemaking. Such review can improve the coordination of agency actions and resolve conflicts among agency rules and assist in the implementation of national priorities.

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[2] Exec. Orders Nos. 11,821, 11,949 (President Ford), Exec. Order 12,044 (President Carter), Exec. Orders Nos. 12,291, 12,498 (President Reagan). For a thorough analysis of the experience under the executive orders, *see* NATIONAL ACADEMY OF PUBLIC ADMINISTRATION, PRESIDENTIAL MANAGEMENT OF RULEMAKING IN REGULATORY AGENCIES (JAN. 1987).

[3] Presidential review, as used in this Recommendation, refers to a program of systematic executive oversight and dialogue that involves coordinating agency actions where conflicts exist, and in all cases probing the agency's fact and policy judgments, with the purpose of ensuring that the agency considers factors of importance to the President's policies to the extent permitted by law. Such review does not displace responsibilities placed in the agency by law nor authorize the use of factors not otherwise permitted by law. Other review of an ad hoc nature by the President (or the President's delegates) of agency rulemaking pursuant to the President's constitutional authority is not within the scope of this Recommendation.

However, not all agency rules or categories of rules may be appropriate for such presidential review. Exempt categories include formal rulemaking, ratemaking, and rulemaking that resolves conflicting private claims to a valuable privilege.

2. *Applicability to Independent Regulatory Agencies.* As a matter of principle, presidential review of rulemaking should apply to independent regulatory agencies to the same extent it applies to the rulemaking of Executive Branch departments and other agencies.

3. *Timeliness of Review.* The process of presidential review of rulemaking, including agency participation, should be completed in a timely fashion by the reviewing office and, when so required, by the agencies, with due regard to applicable administrative, executive, judicial and statutory deadlines.

4. *Public Disclosure of Documents.*

(a) *Proposed or Final Rules.* Where an agency submits a draft proposed or final rule for presidential review, the agency submission and any additional formal analyses[4] submitted for presidential review should be made available to the public when the proposed or final rule to which they pertain is published. If a decision is made to terminate a rulemaking after a notice of proposed rulemaking has been published, agency submissions to the office responsible for presidential review and any additional formal analyses submitted for review should be made available to the public when the decision to terminate is announced.

(b) *Review of Agendas or Other Summaries or Schedules of Agency Rulemaking Actions.* Where an agency submits agendas or other summaries or schedules of pending or planned rulemakings for presidential review, the agency submission and any supporting documents submitted for presidential review should be made available to the public once the agenda or other summary or schedule is made known to the public in an official publication.

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[4] See ACUS Recommendation 85-2, Agency Procedures for Performing Regulatory Analysis of Rules, 1 CFR § 305.85-2.

5. *Executive Branch Communications Relating to Presidential Review of Rulemaking.*

(a) *Policy Guidance.* An agency engaged in informal rulemaking should be free to receive policy guidance concerning that rulemaking at any time from the President, members of the Executive Office of the President, and other members of the Executive Branch, without having a duty to place these communications in the public file of the rulemaking unless otherwise required by law. However, official written policy guidance from the officer responsible for presidential review of rulemaking should be included in the public file of the rulemaking once a notice of proposed rulemaking or final rule to which it pertains is issued or when the rulemaking is terminated without issuance of a final rule.[5]

(b) *Factual Information.* When an agency engaged in rulemaking receives a communication from the office responsible for presidential review which contains factual information relating to the substance of the rulemaking that is not already in the public file, the agency should promptly place the communication (or if oral, a summary) in the public file of the rulemaking.[6]

(c) *Communications Transmitting Outside Comments.* When an agency receives a communication from the office responsible for presidential review which transmits any factual submissions or the views or positions of persons outside the government, the agency should promptly place the communication (or if oral, a summary) in the public file of the rulemaking.[7]

6. *Responsibility of the Reviewing Office Regarding Outside Comments.* The officer responsible for presidential review of rulemaking should not allow the process of review to serve as a conduit to the rulemaking agency for unrecorded communications

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[5] The Conference's position on the public availability of official written policy guidance stated in this Recommendation modifies its earlier position in Recommendation 80-6, Intragovernmental Communications in Informal Rulemaking Proceedings, 1 CFR § 305.80-6, ¶ 1.

[6] Agencies also should place factual information received from other sources in the public file of the rulemaking, *see* Recommendation 80-6, ¶ 2.

[7] This reaffirms the Conference's position on the handling of comments by persons outside the government stated in Recommendation 80-6, ¶ 2.

from persons outside the government. To guard against such occurrence, the responsible officer should take appropriate steps -- and the following should be considered:

(a) identifying any communications to the rulemaking agency that transmit the views or positions of persons outside the government;

(b) promptly transmitting written communications received by the office responsible for presidential review from persons outside the government relating to the substance of a proposed agency rule to the rulemaking agency for inclusion in the public file of the rulemaking;

(c) maintaining a list identifying the time and general topic of oral communications that pertain to the substance of an agency rule under review with persons outside the government and making such list available to the rulemaking agency for inclusion in the public file; and

(d) inviting a representative of the rulemaking agency to attend any meetings between the reviewing office and persons outside the government which pertain to any agency rulemaking under review by that office. The agency representative attending any such meeting should prepare an appropriate summary of the discussion and promptly place it in the public file of the rulemaking.

7. *Not Judicially Reviewable.* The presidential review process should be designed to improve the internal management of the federal government and should not create any substantive or procedural rights enforceable by judicial review.

RECOMMENDATION 88-10:

FEDERAL AGENCY USE OF COMPUTERS IN ACQUIRING AND RELEASING INFORMATION

The rapid evolution of computer technology raises many economic and policy issues that affect the acquisition and release of information by government agencies. New information technologies can improve public access to public information and reduce paperwork burdens. They can also impose significant economic burdens, however, and they may stimulate competition between government agencies and established electronic information enterprises. The essential role of information in a democratic system underscores the need to examine with care the opportunities that electronic information storage and transmission provide for improving the flow of information between government agencies and the public.

The following recommendations are intended to guide agencies in addressing the questions that will arise when an agency considers whether to acquire or release information in electronic form, either to facilitate performance of the agency's mission or to fulfill requirements established by the Freedom of Information Act (FOIA) or other laws.[1]

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[1] OMB Circular A-130 (50 Fed. Reg. 52730, Dec. 24, 1985) provides a general framework for management of federal information resources. The relationship between parts of this recommendation and provisions of the OMB Circular is as follows. Recommendation A reflects the same policy as Paragraph 7(g) of the Circular, but provides additional detail. Recommendation B deals with electronic acquisition, a subject addressed in proposed OMB guidelines, but not in detail in the existing version of Circular A-130. Recommendation C suggests a cost-benefit approach to defining agency electronic dissemination activities essentially consistent

At the present stage in the evolution of government electronic information policy, the most one can do is to suggest an analytical framework within which agency electronic system designers, policy makers, and budget planners can assess their options. The process and substance of decisionmaking within this framework should, of course, conform with general principles of administrative law.

Because experience is now relatively limited and information technology is subject to rapid evolution, when Congress sets policy it should do so on as broad a basis as possible. Because changes in electronic information capability occur at a different pace in different sectors of the society, transitional arrangements will be necessary to ensure that electronic acquisition and release do not disadvantage major segments of the population.

The pertinent considerations depend on the context in which electronic acquisition or release of information is addressed. For example, the factors relevant to the release of information in electronic form in response to discrete FOIA requests differ from those that bear on discretionary agency decisions to release information broadly through electronic publishing. As a further example, resolution of issues pertaining to the acquisition of information in electronic form might depend on such factors as the technological capacity of the private parties from whom electronic filing is to be requested.

Recommendation A addresses the Freedom of Information Act. The FOIA was written with paper records in mind. The problem is to apply the Act to information maintained in electronic form. This recommendation does not seek to provide comprehensive guidance but does address in general terms such matters as whether electronic records should be deemed records subject to

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with that prescribed by the Circular, but offers a finer level of analytical detail to guide agency selection among three different levels of release. Recommendation D suggests defining the boundary between public and private sectors based on a cost-benefit analysis; this is endorsed by Paragraph 7(e) of Circular A-130, but Recommendation D defers less to private sector activities than the Circular. Recommendation E lists more specific cost and benefit categories to be considered than does the Circular. Recommendation F reflects the same policy as that set forth in Appendix IV to Circular A-130 (discussing paragraph 11(a)). Recommendations G and H have no counterparts in the Circular. Recommendation I discusses the role and limits of government-wide policy; Circular A-130 is an example of such a policy. Recommendation J is consistent with Paragraph 9(c) of the Circular.

the FOIA and whether an agency should be expected to write new computer programs for the purpose of responding to a FOIA request.

Recommendations B and C discuss principles applicable to electronic acquisition and release of information, respectively. Recommendation D offers principles for defining the appropriate roles of the public and private sectors in the provision of electronic acquisition and release systems.

Recommendations C and D envision a three-step process for evaluating possible new electronic information products. The first step in the evaluation process is to identify the current level of release of the information that would be contained in a new electronic information product. There are in general terms three possible levels of agency activity in releasing information: (i) "dissemination" or "publishing", leading to the broadest availability of information; (ii) "disclosure", involving wholesaling to private information suppliers or providing electronic release capability in public reference rooms; and (iii) "access", involving ad hoc release in response to discrete requests. For the special meaning of these and other related terms used in this recommendation, it is important to refer to the appended glossary.

The second step is to identify the benefits and costs of replacing or supplementing existing means of release with various levels of electronic release. An agency should not offer an electronic information product unless the cost-benefit analysis demonstrates that the electronic alternative analyzed is likely to be superior to existing means. The third step is to define the most desirable public and private sector roles, applying principles described in Recommendation D.

Deciding to "promote" electronic publishing does not necessarily mean a direct, retail, electronic publishing and distribution role for the government, if private sector electronic publishing activities and commitments are more cost effective (see Recommendation D). Electronic publishing contemplated by this recommendation also can occur through depository libraries. In some cases it may be appropriate to retain both paper and electronic versions of the same information, even though costs almost certainly will be higher than for either form alone.

Recommendation E identifies cost and benefit categories that should be considered in applying Recommendations B, C and D. Recommendations F through J deal with discrete questions of policy and technology: for example, the use of private telecommunications systems, the undesirability of exclusive private or public control of information, and the need to stay abreast of developing technologies.

These recommendations do not address such important issues as protection of trade secrets or privileged commercial information, invasion of personal privacy, or the need for Congress and agencies to consider allocating budgetary resources so that FOIA staffs will include persons skilled in using electronic databases. Nor do they address in detail the security of electronic databases. Those subjects deserve separate investigation.

The recommendations also do not address issues pertaining to automation of internal agency functions including important questions of records retention, evidentiary use of electronic records, and program administration. Rather the recommendations assume that an agency has automated or will automate an identifiable portion of its activities and therefore is confronted with the questions of whether and how to establish interfaces between internal electronic information systems and the outside world.

RECOMMENDATION

A. Freedom of Information Act

1. In interpreting the Freedom of Information Act, agencies should recognize that a "record" includes information maintained in electronic form.

2. Agencies using electronic databases rather than paper records should not deny access to the electronic data on the grounds that the electronic data are not "records," that retrieval of the electronic information is equivalent to creation of a "new" record, or that programming is required for retrieval. In responding to FOIA requests, agencies should provide electronic information in the form in which it is maintained or, if so requested, in such other form as can be generated directly and

with reasonable effort from existing databases with existing software. Agencies, however, should not be obligated under the FOIA to create large new databases for private advantage, thus using agency resources for private purposes. Agencies should use a standard of reasonableness in determining the nature and extent of the programming that provides an appropriate search for and retrieval of records in responding to FOIA requests, and in determining the extent to which FOIA requesters may ask the agency to produce data organized in formats other than those used by the agency in the regular course of its operations.[2]

3. Differences in technologies and database structures used by individual agencies make it necessary, for the near term, to define FOIA obligations on a case-by-case basis. Further experience with electronic information systems is a prerequisite to the formulation of general rules applicable to such controversies under the Act as how requesters must identify the records sought, how much programming, if any, an agency must do, and how costs shall be borne. The concept of reasonableness applied to searches for paper information made in response to FOIA requests should provide a useful guideline for resolving controversies over the application of FOIA to electronically maintained data.

B. Acquisition of Information in Electronic Form

1. Agencies should acquire information in electronic form when they use, or will use, the information in that form and when most information submitters already maintain information electronically, or have ready access to intermediaries who will prepare and submit it in electronic form. When agencies sponsor electronic acquisition programs, they should make clear their intention that all information required will eventually be available to them in electronic form, either by strictly administering exceptions to mandatory programs, or by undertaking the conversion of paper submissions into electronic form themselves.

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[2] Agencies should be able to recover the costs of complying with FOIA requests, including programming costs, in a manner consistent with the Freedom of Information Reform Act of 1986, 100 Stat. 3207, 3207-48 (1986), amending 5 U.S.C. §552(a)(4)(A), and related OMB guidance, 52 Fed. Reg. 10012, 10017 (1987).

2. When most providers of information ("filers") are technologically sophisticated, it is appropriate for agencies to require electronic filing of information, after developing standard formats in consultation with the filer community, and after appropriate testing and transition periods.

3. In determining whether to require or permit electronic filing of information and in designing the particulars of an electronic acquisition program, agencies should carefully weigh the costs and benefits of electronic acquisition of information. The analysis should address the factors identified in Recommendation D together with other considerations made relevant by the agency's mandate.

4. Agencies initiating electronic acquisition programs should take steps to facilitate electronic filing by entities having limited technological capacity (without raising the costs for sophisticated entities), including the optional use of "smart forms." When a significant proportion of the filer community is technologically unsophisticated, electronic acquisition may be feasible only through intermediaries. In such cases, agencies should create economic incentives for electronic filing rather than mandating it. Part of the economic incentive to file electronically under voluntary electronic acquisition programs can be the imposition of a fee on technologically sophisticated filers who choose to file on paper, assuming the statutory authority to do so exists.

C. *Release of Information in Electronic Form*

1. Electronic information release policies should depend on such factors as (a) whether the desired level of release consists of electronic publishing, electronic disclosure, or electronic access in response to FOIA requests (see the glossary for definitions of these terms); (b) the agency's policies in releasing like information maintained in paper records; and (c) the costs and benefits of replacing or supplementing an existing paper medium with an electronic medium.

2. When a statute or agency policy mandates the publishing of information, the agency should itself electronically publish the information or facilitate its electronic publication by others, unless the cost-benefit analysis suggests the desirability of

restricting publishing to the paper medium, possibly accompanied by a lower level of electronic release.[3] If the agency publishes the information only on paper, it should consider electronic publication of the availability of the paper information products. Where an agency publishes information electronically, it should consider the feasibility of providing dial-up access.

3. When a statute mandates public reference room disclosure, or paper products presently are made available through a public reference room, agencies should provide electronic disclosure in public reference rooms of information already in electronic form. Such agencies should consider the costs and benefits of upgrading from electronic disclosure to electronic publishing. Agencies should also make information disclosed electronically available to any requester in an electronic form that would be easily usable by information resellers.

4. In those instances where an agency maintaining information in electronic form has no mandate to release information other than in response to FOIA requests, the agency should consider upgrading release of appropriate parts of this information to electronic disclosure through public reference rooms and wholesaling in electronic bulk form to private sector requesters.[4]

D. Allocation of Responsibilities Between Public and Private Sectors

1. Agencies that have decided under Recommendations B and C to acquire or release information in electronic form should define the appropriate roles of the public and private sectors in providing that information and related products (including telecommunications facilities, indexes and retrieval software as well as raw data). That choice should depend on

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[3] When a statute mandates electronic publishing, the agency would not have discretion to restrict publication to a paper medium or to a lower level of electronic release.

[4] The prices for such electronic information would be determined under the general user fee statute, 31 U.S.C. §9701, or under the FOIA. See OMB's user fee guidelines, restated in App. IV to OMB Circular A-130, 50 Fed. Reg. 52748 (1985).

the relative costs and benefits of privately versus publicly provided information products.

2. When choosing between publishing and a lower level of electronic release of information, an agency should determine whether private sector providers are willing to supply electronic products having features (e.g., user-friendly menus) that will give the public greater benefits or lower costs than would electronic publishing by the agency. When an agency relies on the private sector for electronic publishing of agency information, the agency should seek to establish by contract the nature of the products to be provided.

3. When an agency determines that its mission warrants new electronic means of acquisition or release of information and the private sector will not commit to provide them at appropriate prices, the agency should provide them, if clearly identified non-economic and economic benefits outweigh the capital and marginal costs. Agencies should recognize, however, that there may be circumstances where the costs to an agency would suggest the wisdom of creating incentives for the private provision of the desired electronic information product -- for example, the free use of agency-developed software.

E. *Determination of Costs and Benefits*

1. Agencies should take into account the following costs in the decisionmaking processes suggested in Recommendations B, C and D:

(a) Capital costs to the agency of establishing the product, and the probable economic life and other uses over which the costs should be allocated;

(b) Capital costs to information consumers and information providers to utilize the product, and the probable economic life and other uses over which these costs should be allocated;

(c) The marginal costs to the agency for user access;

(d) Marginal costs to users for obtaining the information;

(e) Marginal costs to electronic information providers of updating the electronic information;

(f) Unrecovered costs associated with existing government or private sector capital that would be made obsolete by the new product;

(g) The costs of updates and upgrades in service levels or capacity necessary to permit intended benefits to be realized at levels of demand expected over the long term; and

(h) Costs of changing to standard formats or of handling different formats.

2. Agencies should take into account the following benefits in decisionmaking processes suggested in Recommendations B, C and D:

(a) Savings associated with eliminating the cost of producing and maintaining existing paper products;

(b) Savings to agencies and consumers associated with upgrading the level of information release from ad hoc FOIA disclosure to electronic disclosure in a public reference room;

(c) Savings to agencies and consumers associated with upgrading paper public reference room disclosure to electronic publishing;

(d) Increase in the number of interested persons having access to information;

(e) Improvements in the utility of information for its intended purpose because of improved organization and retrieval capabilities; and

(f) Reductions in delays associated with transferring information from an agency to eventual consumers.

3. Cost-benefit analyses should take into account FOIA obligations, including obligations to protect trade secrets and other exempt information. In designing electronic databases, agencies should consider the types of FOIA requests likely to

be received for data in the database, consulting with representative users when feasible. Insofar as it is consistent with agency mission performance, databases should be designed so as to facilitate responses to FOIA requests. A proper rule of thumb is that it should not be any more difficult to obtain information under the FOIA after automation than before.

4. In some cases, effective design may require some sacrifices in electronic FOIA retrieval capability. In these cases, agency designers of electronic databases and retrieval software should consider how FOIA requests can be satisfied consistent with the spirit of the Act. For example, an agency might choose to make raw data available to requesters in computer-readable form along with retrieval software, so that requesters can effect their own retrievals. In other situations, new electronic information products may reduce costs of FOIA requests, to both requesters and agencies. This would occur, for example, if information were published or otherwise made accessible electronically in a public reference room, rather than provided only on paper in response to FOIA requests.

F. Exclusive Control of Public Information. An agency generally should not grant a private party exclusive control of its electronic information or of the acquisition or release thereof. Nor should the agency itself as a general matter maintain such control in the absence of a compelling public purpose. Where an agency has, and wishes to exercise, authority to enter into an exclusive arrangement providing a private sector vendor with a preferential right to electronic information, the agency should first consider whether the analysis suggested in Recommendations B, C, D and E demonstrates that efficiencies can be achieved through such an arrangement. The agency should also guard against the possibility that the arrangement may be inconsistent with its responsibilities under the FOIA or may impair the ability of the agency and the public to benefit from subsequent technological developments.

G. Technology Issues

1. Agencies should use proven technologies in their electronic acquisition and release systems. They should stay abreast of the state-of-the-art in all matters related to the electronic acquisition and release of information and should be

particularly alert to the need for up-to-date and effective access control and other techniques required to maintain an appropriate level of security.

2. Agencies should seek to base electronic information formats on existing standards efforts such as American National Standards Institute standards on Electronic Business Data Interchange[5] before developing their own distinctive format definitions.[6]

3. Whenever possible, agencies should use public data networks rather than developing their own communications links for public filers or consumers.

4. Agencies should consider conducting demonstration projects to experiment with evolving electronic information technology.

H. Electronic Participation in Administrative Proceedings. Agencies should experiment with electronic means of providing public participation in rulemaking, adjudication and other administrative proceedings, while retaining a means of effective participation for persons who lack the means to access the electronic information system.

I. Government-wide Policy on Electronic Information

1. A government-wide policy on electronic information is desirable to afford guidance to agencies. Such a policy should articulate goals consistent with those expressed in the foregoing recommendations.

2. Congress should formulate the larger value judgments necessary for a government-wide policy on electronic information.[7] These include the roles of public and private sectors; who ought to pay for increased information utility; and the level of funding to be provided by the government.

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[5] These standards are currently designated as "X.12".

[6] Cf. Recommendation 78-4, Federal Agency Interaction with Private Standard-setting Organizations in Health and Safety Regulation, 1 CFR §305.78-4.

[7] See, e.g., U.S. Congress, Office of Technology Assessment, *Informing the Nation: Federal Information Dissemination in an Electronic Age* (October 1988).

3. Because agencies often are in the best position to apply the considerations identified in this recommendation, Congress should normally defer to agency judgment in selecting methods to implement congressionally enacted policies when the agencies have offered rational justifications for their electronic information program decisions.

*J. National Institute of Standards and Technology.*_The National Institute of Standards and Technology should continue to work with the U. S. Patent and Trademark Office to advance electronic data storage and transmission technology, as, for example, its work with high-capacity storage technology, and should inform agencies about commercially available products and services to facilitate electronic acquisition and communications.

GLOSSARY

Bulk form: large quantities of data in nearly raw form, with little formatting information or other added value, usually maintained and transferred on magnetic tape or cassettes or high capacity optical or magnetic disks.

Data product: a specific form of electronic information, sometimes including data structures, indices, retrieval software, and telecommunications links.

Database: a body of information maintained in electronic form, from which parts can be retrieved electronically.

Dial-up: a form of electronic dissemination through which anyone with a computer, a modem, and access to an ordinary telephone line can retrieve information from an electronic database.

Electronic access: the lowest level of electronic release; the ability to obtain agency information; communicating information to consumers.

Electronic acquisition: obtaining information from the public electronically; includes electronic filing; submitting information to an agency in electronic form.

Electronic disclosure: an intermediate level of electronic release; making information available electronically to the public at one or only a few places.

Electronic dissemination: the highest level of electronic release; using electronic means to make information widely available to the public at places where it is used; same as electronic publishing.

Electronic publishing: same as electronic dissemination.

Electronic release: communicating information to users in electronic form; a generic term that includes access, disclosure, and dissemination.

Hardware: computers and associated peripherals.

Public data networks: communications common carriers that aggregate small volume data communications and thereby reduce the cost of high-quality transmission of data.

Retailing: providing information in a format different from that used by the government, or with accompanying analysis, aggregation or segregated subsets, enhanced search or retrieval capabilities, or otherwise tailored to be of value to specialized or individual end users; also may include distribution components of electronic release.

Retrieval: extracting a part of a database and presenting it to the requester in a form understandable by humans.

Smart forms: interactive computer data acquisition programs that guide the filer in answering questions.

Software: computer programs or data.

Wholesaling: providing resellers or large end users information only in the form used by the government or only in bulk form.

RECOMMENDATION 88-11:

ENCOURAGING SETTLEMENTS BY PROTECTING MEDIATOR CONFIDENTIALITY

The resolution of issues through negotiations among the affected parties has long been recognized as an essential ingredient of the administrative process.[1] Settlements bring to bear parties' experience, foster creative solutions, and result in faster decisions requiring fewer resources than formal litigation. Most settlements now occur simply though ad hoc negotiations among the lawyers for the parties, generally on the eve of hearing. The Administrative Conference has recommended that agencies adopt alternative means of dispute resolution ("ADR") to enhance negotiations and stimulate the possibility of reaching agreement expeditiously within the confines of the agency's authority and policy.[2]

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[1] As the influential Attorney General's *Manual on the Administrative Procedure Act* explained in 1947,

> [t]he settlement of cases and issues by informal methods is nothing new in Federal administrative procedure. In its Final Report, the Attorney General's Committee on Administrative Procedure pointed out . . . that "even where formal proceedings are fully available, informal procedures constitute the vast bulk of administrative adjudication and are truly the lifeblood of the administrative process."

[2] The Conference has repeatedly recommended that agencies employ ADR. Recommendation 86-3 calls on agencies to make greater use of mediation, facilitation, negotiation, minitrials, and other "ADR" methods to reduce the delay and contentiousness that accompany many agency decisions. *E.g., Agencies' Use of Alternative Means of Dispute Resolution*, 1 CFR § 305.86-3; *Alternatives for Resolving Government Contract Disputes*, 1 CFR § 305.87-11; *Procedures for Negotiating Proposed Regulations*, 1 CFR §§ 305.82-4, 85-5; *Negotiated Cleanup*

This recommendation seeks to encourage agency use of alternative means of dispute resolution by affording appropriate protection to communications between the parties and the neutral in settlement negotiations. The Conference, of course, recognizes the principle that decisions affecting the public welfare ought to be made in the open and subject to public and judicial scrutiny. Nevertheless, since settlements are essential to administrative agencies, a careful balance must be struck between the openness required for the legitimacy of many agency agreements and the confidentiality that is critical if sensitive negotiations are to yield agreements. This recommendation attempts to strike that balance, without thwarting open decisionmaking.

Most ADR techniques, including mediation, non-binding arbitration, factfinding and minitrials,[3] involve a neutral third party who aids the parties in reaching agreement that resolves the issues in controversy. A skillful mediator can speed negotiations and increase chances for agreement by holding separate confidential meetings with the parties, where each party may give the mediator a relatively full and candid account of its own interests (rather than its litigating position), discuss what it would be willing to accept, and consider alternative approaches. The mediator, armed with this information but avoiding premature disclosure of its details, can then help to shape the negotiations in such a way that they will proceed most directly to their goal. The mediator may also carry messages between the parties, launch "trial balloons," and act as an agent of reality to reduce the likelihood of miscalculation. This structure can make it safe for the parties to talk candidly and to raise sensitive issues and creative ideas. In non-binding arbitration, minitrials and factfinding, the neutral may play a different role from that of a mediator, because he may issue a tentative decision that is then used as a basis for negotiations, but all of these neutrals have the common characteristic of helping the parties negotiate an agreement.

With all of these neutrals, many of the benefits of ADR can be achieved only if the proceedings are held confidential. Confidentiality assures the parties that what is said in the

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of Hazardous Waste Sites Under CERCLA, 1 CFR § 305.84-4; *Resolving Disputes under Federal Grant Programs*, 1 CFR § 305.82-2.

[3] For brief definitions of these terms, *see* the Appendix to Conference Recommendation 86-3, *supra*.

discussions will be limited to the negotiations alone so they can be free to be forthcoming. This need extends to the neutral's materials, such as notes and reports, which are produced solely to assist the neutral in the negotiation process and which others could misconstrue as indicating a bias against some party or interest. This is why many mediators routinely destroy their personal notes and drafts and return all other materials to the parties. Moreover, if the neutral were to testify in a subsequent proceeding as to what went on during the negotiations, his neutrality might be destroyed. The ADR process could be jeopardized because one party or another is likely to feel disadvantaged. Also, the parties would justifiably feel their confidences might be threatened. All this would certainly inhibit future participation by parties and neutrals.

Limited protection for settlement negotiations and work product developed in preparation for litigation is provided by Rule 408 of the Federal Rules of Evidence and Rule 26(b)(3) of the Federal Rules of Civil Procedure. However, uncertainties as to their application--not to mention the effects on confidentiality of the Freedom of Information Act--may raise obstacles to protecting communications with ADR neutrals in federal agencies' disputes. As a result, many statutes, rules, and guidelines have explicitly provided for some degree of confidentiality of mediation and similar materials.

The Administrative Conference takes the view that maintaining confidentiality of settlement discussions is consistent with the principles underlying the FOIA, Rule 408 of the FRE, Rule 26(b)(3) of the FRCP, and the work product doctrine. To encourage the use of ADR in negotiations, the recommendation contains a model rule seeking to protect the communications between the neutral and the parties or other participants in the course of the negotiations as well as the neutral's own notes and impressions. It does so in recognition that the mediator will virtually *never* have information or evidence that is not shared by at least one other person, excepting of course the neutral's own notes, recollections, and judgments. The rule does not address (1) when meetings or negotiations should be held in public session, (2) what justification should be prepared to support any agreement reached, or (3) what information should be available from a party to the negotiations. The rule covers oral communications or actions that are related to a settlement proceeding, as well as documents that are created specifically for the negotiations or other, previously existing documents that are furnished to the neutral in confidence by a participant in the negotiation. The restrictions on the neutral's disclosing information from the negotiation are not categorically absolute, being subject to several narrow exceptions that deal with extraordinary cases. Finally, the model rule does not attempt to impose its terms on all parties for all issues; they would be free to vary the terms for their particular negotiations.

RECOMMENDATION

1. Agencies that use the services of neutrals in settlement proceedings:

(a) should explicitly indicate that as a matter of policy they will not seek to discover or otherwise force disclosure of a neutral's notes, memoranda or recollections or of documents provided to the neutral in confidence in the course of settlement negotiations;

(b) in arranging with an individual or organization to serve as a neutral in settlement proceedings, should include a provision in any agreement with the neutral that (i) the agency makes no claim to the neutral's notes, memoranda or recollections or to documents provided to the neutral in confidence in the course of the settlement negotiations and (ii) that such material is outside the scope of the agency's right to any data developed pursuant to the agreement; and

(c) should adopt a procedural rule, consistent with the model rule contained in the appendix below, for all cases where the agency itself is a party to the negotiations or where private parties are negotiating the resolution of an issue in controversy concerning a statute, regulation, or policy administered by the agency.

2. The neutral, including a neutral (as defined in the model rule) who serves as a presiding officer,[4] should carefully

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[4] *See, e.g.*, Recommendation 88-5, *Agency Use of Settlement Judges*, 1 CFR § 305.88-5.

segregate, and identify as settlement documents, all materials received or developed during the course of a settlement proceeding, including any retained following its conclusion, so they will be used solely to assist the neutral in working to settle the issues in controversy.

3. Agencies should interpret the FOIA, Rule 408 of the Federal Rules of Evidence, Rule 26(b)(3) of the Federal Rules of Civil Procedure, and the work product doctrine to avoid disclosure of settlement communications by neutrals serving in administrative settlement proceedings.

APPENDIX

Model Rule

§ xxx.1 Introduction; Encouraging Settlement; ADR Techniques

(a) To facilitate a vigorous enforcement program and expeditious administrative decisionmaking, [the agency] encourages the resolution of issues in controversy through negotiations among the affected parties. Voluntary settlement processes within [the agency's] statutory mandates and existing policies can produce decisions more efficiently than traditional procedures, and often yield decisions that are more effective than those reached without the concurrence of persons with firsthand involvement. Settlement agreements thereby enable the agency and the parties to accomplish their goals with expenditure of fewer resources.

(b) In addition to unassisted negotiations among the affected interests, alternative means of dispute resolution ("ADR") can aid the parties in reaching agreement in appropriate cases. These techniques include facilitation, mediation, minitrials, factfinding, and non-binding arbitration. In each, a neutral third party helps the parties reach a voluntary agreement. [The agency] encourages the use of these ADR processes as part of its policy favoring settlements.

(c) The voluntary settlement of issues in controversy through a dispute resolution process requires integrity, objectivity, and fairness on the part of the neutral and of the process itself. Moreover, the parties must feel free to discuss the dispute with the neutral without fear of being disadvantaged by the negotiations. [The agency] takes the position that the public policy favoring voluntary resolution of disputes therefore requires that the neutral not reveal, either voluntarily or through legal compulsion, information learned in confidence during the negotiations. To encourage the parties to negotiate, this rule enunciates an agency policy seeking to protect the confidentiality of settlement negotiations involving the neutral.

§ xxx.2 Definitions. As used in this rule:

(a) "Issue in controversy" means a question that is material to a decision involving a statute, regulation, or policy administered by [the agency] about which persons who would be substantially affected or the agency disagree.

(b) "Settlement proceeding" means any process, such as facilitation, mediation, minitrial, factfinding, or non-binding arbitration, that is used to resolve issues in controversy by agreement of the parties in which a neutral serves, whether or not administrative or judicial proceedings have been instituted.

(c) "Neutral" means an individual who with respect to the issues in controversy--

(1) is not a party;

(2) does not have any official, financial, or personal conflict of interest unless such interest has been fully disclosed in writing and all parties agree that the individual may nevertheless serve as a neutral; and

(3) works to aid the parties in arriving at settlement of the issues in controversy through agreement.

(d) "Settlement communication" means any oral or written communication or conduct made in confidence and in connection with a settlement proceeding by any party, neutral, non-party participant, or other source of information relevant to the proceeding.

(e) "Settlement document" means any written material that is--

(1) prepared for the purpose of, in the course of, or pursuant to a settlement proceeding, including memoranda, notes, and work product of the neutral and the parties, or

(2) provided to the neutral in confidence for purposes of the settlement proceeding.

An agreement reached as a result of a settlement proceeding is not a settlement document unless the parties agree in writing, and the law allows, that it shall be regarded as such.

(f) "In confidence" means with the expressed desire of the source that the information be kept confidential or provided under circumstances that would create the reasonable expectation that it will not be disclosed.

(g) "Party" means a person or entity whose dispute is the subject of the settlement proceeding, including representatives of such a party.

(h) "Non-party participant" means a person or entity who is not a party to the dispute but who participates in the settlement proceeding, such as by providing information, analysis, advice, or views.

§ xxx.3 Applicability of the Rule

(a) This rule applies to any settlement proceeding whether or not [the agency] is a party if the parties communicate with the neutral under circumstances that reasonably imply that the parties expect that the communications will be held confidential. Prior to beginning substantive negotiations, the parties may (1) agree that this rule does not apply to their negotiations or (2) modify the terms of this rule by agreement in which case that agreement will prevail to the extent it is authorized by law or is otherwise consistent with this rule. So that the neutral can decide whether he wishes to serve under those conditions, the parties shall so inform the neutral otherwise prior to commencing settlement proceedings. If they fail to do so, this rule shall apply.

(b) The provisions of the rule take effect when--

(1) a person has been specifically requested or accepted by at least one party to (i) serve as the neutral in the settlement proceeding, or (ii) discuss the potential of conducting a settlement proceeding, or (iii) contact other potential parties to determine whether it would be appropriate to convene a settlement proceeding to resolve the issues in controversy;

(2) the other parties with whom the neutral has contact knows that he or she is occupying the role of a neutral; and

(3) they communicate with the neutral in that capacity.

(c) The rule does not address--

(1) the extent to which a party may disclose settlement documents and communications either voluntarily or in response to discovery or legal process; or,

(2) the information that is required to support a decision or agreement reached in a settlement proceeding.

§ xxx.4 Neutral Impartiality and Confidentiality of Settlement Negotiations

(a) A neutral shall not voluntarily or through compulsory process disclose or testify concerning settlement communications or settlement documents, unless--

(1) all parties to the settlement proceeding and the neutral consent in writing, and if the settlement communication or document was provided by a non-party participant, that participant also consents in writing;

(2) the request is for a settlement document that was provided to the neutral in a public meeting or is otherwise already in the public domain;

(3) the settlement document is required by law to be made public, but only if it is not available from the person who prepared it or from any other source;

(4) a court determines that there is a need for such testimony or disclosure. The agency takes the position that any such determination should be pursuant to a finding that the need for disclosure to--(i) prevent a manifest injustice, (ii) reveal a violation of law, or (iii) protect the public health or safety is of sufficient magnitude in the particular case to outweigh the integrity of settlement proceedings in general by reducing the confidence of parties in future cases that their communications will remain confidential; or

(5) the settlement document or communication is relevant to the resolution of a dispute between the neutral and a party or participant, but only to the extent that the document or communication is used for purposes of resolving that dispute and not any issue in controversy in the settlement proceeding.

(b) If a demand, by way of discovery request or other legal process, is made for disclosure by the neutral of a settlement document or communication, the neutral shall make reasonable efforts to notify the parties and any affected non-party participant so that countermeasures may be taken if desired.

§ xxx.5 Agency Records

(a) The agency makes no claim of control or ownership over the notes, memoranda, and other work product prepared by a neutral or by his or her staff in connection with a settlement proceeding.

(b) The agency takes the position that settlement documents and communications are not agency records solely on account of their having been received by the neutral during a settlement proceeding; a document or other material that is otherwise an agency record remains as such.

STATEMENT 13:

DISPUTE RESOLUTION PROCEDURE IN REPARATIONS AND SIMILAR CASES

Where Congress has established private rights, effective means of protecting them are crucial. Congress has used a variety of procedures to protect consumers, workers and certain others. In many cases, it has established formal adjudicatory processes (e.g., within regulatory agencies like the Federal Trade Commission or review agencies like the Occupational Safety and Health Review Commission). Congress has also recognized that, in many cases, formal agency hearings or court litigation may be unnecessary or too costly. Thus, alternative or supplementary agency procedures or even private-sector procedures have been established to resolve disputes that formerly would have been left to the formal adjudication process.

Agencies' use and oversight of these dispute processes has become even more important in light of recent congressional developments and Supreme Court decisions. The Supreme Court recognized in *Shearson/American Express, Inc. v. McMahon*, 107 Sup. Ct. 2332 (1987), for example, that arbitration processes are often adequate to protect statutory rights, particularly where an agency can oversee their operation to ensure their adequacy. Indeed, that case enforced an arbitration agreement even for a treble damage case brought under the Racketeer Influenced and Corrupt Organizations Act by a plaintiff acting much like a "private attorney general."

Agencies' approaches to "reparations" and similar programs to safeguard consumers reflect the diversity of approaches that are available. The Securities and Exchange Commission, so far at least, has relied on a purely private resolution mechanism--

exchange-based arbitration. The Commodity Futures Trading Commission ("CFTC"), has developed, pursuant to statutory mandate, its own distinctive dispute resolution program. Since it was formed in 1974, the CFTC has administered a "reparations" program that adjudicates between commodity futures salespersons (known as "futures commission merchants") and aggrieved customers.[1]

The CFTC's program provides an interesting alternative to civil litigation, formal hearings under the Administrative Procedure Act, and commercial arbitration.[2] Like arbitration (which is also an option available to aggrieved customers), the reparations program uses decisionmakers familiar with the industry from which the disputes arise. But these decisionmakers are CFTC employees, rather than arbitrators drawn from industry--either agency administrative law judges or other specially-designated agency employees known as "judgment officers".

The CFTC has been creative in fashioning procedures for the reparations program. The "formal" procedure, for claims of more than $10,000, is akin to the adjudicatory procedure provided in Section 554 of the APA. The "summary" procedure for claims under $10,000 dispenses with several formalities, including the right to an oral hearing. It does permit a telephonic hearing. A third, "voluntary" procedure, is available for claims of any size and must be elected by both parties. It dispenses with a written opinion by the presiding judgment officer and appeal rights. While the CFTC's program had a troubled early history, characterized at times by crippling case backlogs and severe budgetary constraints, recent years have seen enhanced resources and a considerable improvement in case management.

The Administrative Conference has begun exploring these processes with its research into the CFTC's innovative approach to consumer protection. The Conference sees important benefit in programs, like the CFTC's, that offer complainants procedural options. Creation of an agency review process for consumer complaints benefits the regulatory agency because the process provides a valuable pipeline into the problems of the industry; resolving these complaints serves as a constant challenge and impetus to the agency to interpret its statutory mandate. A three-tiered approach like the CFTC's permits added opportunities for procedural tailoring. On the other hand, the parallel private decisional process may be less expensive, faster, and more responsive. Parties benefit from having both a choice of forums and an opportunity to select a dispute resolution procedure that suits their needs.

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[1] Other agencies, like the Federal Maritime Commission and the U.S. Department of Agriculture, have reparations programs that differ in significant respects.

[2] Persons with reparations claims may pursue several other avenues of redress (National Futures Association arbitration, private suits), so the entire CFTC program is in essence voluntary.

Much remains to be done in considering the best approach for particular agencies, and this statement is intended as an initial foray. The Administrative Conference suggests that continued experimentation with alternative types of procedures for resolving issues arising in consumer protection programs is justified. Agencies administering statutes that recognize a private right of action should consider establishing, or seeking authority to establish, a reparations program offering creative procedures for "formal," "summary" and "voluntary" dispute resolution, along the lines of the CFTC's where:

(1) An agency statute provides for and engenders substantial private litigation and/or arbitration; or

(2) An agency regulatory program centers on a single industry or group of similar industries, such as would permit creation of "expert" decisionmakers.

An agency with both of the characteristics listed above would be a prime candidate for a reparations program. Each program of course would be crafted to meet the special needs of the agency's particular regulatory jurisdiction.

Management of reparations programs should take into account these factors:

(1) Where complaints are to be resolved by summary or voluntary procedures, the discovery process should be streamlined to comport with the goals of less formal procedures. For example, the number of interrogatories and requests for admissions may be substantially limited; and summary information rather than facsimiles could be deemed responsive to requests for the production of documents.

(2) The judgment officers used in summary and voluntary procedures need not always be administrative law judges or even attorneys, so long as they demonstrate sufficient experience in, or knowledge of, the regulated industry or applicable law.

(3) While summary procedures by their nature may not require an in-person hearing, telephone hearings may provide a useful and inexpensive way of allowing the judgment officer to question parties and witnesses. Telephone hearings should be available whenever a judgment officer believes such a hearing is appropriate to the resolution of a dispute.

(4) Since complainants in reparations proceedings frequently appear without a lawyer, agencies should make the dispute resolution process understandable to the lay person. Toward that end, notices and descriptions of the process should avoid whenever possible the use of legal terms (e.g., "pleadings" or "discovery") where a colloquial term will suffice. Where use of a lay term would mislead, or where no appropriate term is available, agencies should make every effort to assure that the legal term of art has been translated for the lay party or even provide a glossary of such terms for the benefit of the lay reader.

(5) Managers should assure that a sufficient number of judgment officers are employed to reduce the overall processing time for summary and voluntary proceedings, and thus to permit those forms of procedure to fulfill their promise.

(6) Case tracking systems for reparations cases should be used, or modernized, so that the location and progress of any case can be quickly identified and bottlenecks eliminated.

REPORTS

FOR

RECOMMENDATIONS 88-1 THROUGH 88-11

AND

STATEMENT 13

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-1

STANDARDS OF CONDUCT FOR PRESIDENTIAL TRANSITION WORKERS

by

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I. INTRODUCTION

The transfer of power from one administration to another poses an enormous task. In the roughly ten weeks between the election and Inauguration Day, the President-elect's transition team must identify over a thousand people to fill high level positions, prepare a strategy for providing leadership during the crucial first months, and design a blueprint for taking over the day-to-day management of the federal government. Doing so requires comprehensive information on the organization and responsibilities of each agency and program, on their plans and concerns, on the resources available, on the legislative and regulatory initiatives that are being prepared, on the program's personnel, on grants and contracts that have been or are about to be awarded, and on the policy questions that will need to be decided.

Private citizens must necessarily be relied upon to accomplish this awesome responsibility. During the 1980-81 transition, for example, more than six hundred people had active assignments on transition teams, significant numbers of whom continued to be paid by their private employers. Indeed, many of them were chosen precisely because of their substantive knowledge of the agency's programs which was derived from jobs that brought them into contact with the agency.

The magnitude and importance of the tasks, and the short period available to complete them, necessitate that future Presidents-elect will continue to rely on an army of private citizens, some of whom may later be offered government appointments, but many of whom will return to the employment whence they came.

While the complexities of a Presidential transition place an enormous burden on the President-elect and his staff, the incumbent President and executive branch officials also face a difficult responsibility. They must typically deal with people from the transition organization who have widely different backgrounds, with a resulting array of sophistication and understanding of the subtlety of the issues facing the agency. Exacerbating this inherent problem, the history of transitions demonstrates that it is not always easy to determine just who actually speaks for the President-elect and who should be provided with information and access to personnel that are not normally publicly available. Yet, if an incumbent administration hesitates in rendering assistance, transition officials may view such conduct as obstructionist, thereby straining relations and making it more difficult for the President-elect to gain control over the federal bureaucracy. Or, they may provide sensitive information to those who are not actually authorized by the President-elect's team but rather who are self-appointed helpers.

The prospect of large numbers of transition workers with sometimes ambiguous authority and with special access to government information, personnel, and facilities carries with it the inherent potential for conflicts of interest or the abuse of public trust. To be sure, the constant scrutiny by the press and the major embarrassment that would result if an abuse were to materialize provide a strong inducement to the transition team to ensure that none arises.

Nevertheless, the possibility for controversy over whether private sector people with exceptional avenues into agencies have onflicts of interest has arisen in an analogous setting. Shortly after taking office, President Reagan issued an Executive Order establishing the Executive Committee of the Private Sector Survey.[1] It was to conduct in-depth reviews of Executive Branch operations and advise the President and the heads of the federal agencies. Popularly known as the Grace Commission, after its chairman Peter Grace, the Commission itself consisted of approximately 150 senior corporate executives. It was funded by a private foundation created for the purpose. A series of "task forces" was charged with surveying the respective agencies, conducting the preliminary fact-gathering, and formulating the initial recommendations for the consideration of the Executive Committee. Each task force was chaired by a member of the Executive Committee and staffed with other volunteers. Together, nearly a thousand private citizens served.

This effort in many ways resembled a Presidential transition -- individuals who continued to be employed by private firms had extraordinary access to government agencies for a temporary period, made high-level recommendations concerning the agencies with which they were dealing, and returned to their own employers. The effort was controversial: charges were made that the task force members had conflicts of interest, and it was urged that they should be subject to the federal conflict of interest requirements.[2] While the federal conflict of interest requirements applied to the members of the Executive Committee itself, the task force members were exempt. Perhaps this experience alone indicates the wisdom of having some sort of baseline conflict of interest requirements and guidelines for agencies in dealing with similar efforts.

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[1] Exec. Order 12,369, 47 Fed. Reg. 28899 (1982).

While no known serious problems have arisen during recent transitions, because the Presidential transition occupies a peculiar place in governmental organization, because the application of the federal conflict of interest provisions is not always clear,[3] and because of the inherent potential of at least the appearance of conflicts of interest, it is appropriate to develop standards of conduct for the transition effort to ensure an orderly transition that maintains the public's confidence.

Transition officials do not have the authority to make government decisions, and they have special access to agencies for a very brief time. It is therefore not essential that they be subjected to the full rigor of the conflict of interest rules that govern full-time employees. Moreover, imposing such requirements would likely inhibit the ability of the President-elect to secure the services of individuals he would like to enlist. The applicable conflict of interest requirements, especially those that apply to part-time or temporary employees, do provide a starting point that can provide the basis for those that might appropriately be imposed, however.

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[2] See, e.g., *National Anti-Hunger Coalition v. Executive Committee*, 557 F. Supp. 524 (D.D.C.), *aff'd* 711 F.2d 1071 (D.C. Cir. 1983); Cohen, *Reagan's Cost Control "Bloodhounds" Are Hounded by Charges of Conflicts*, National Journal (January 15, 1983) at 122.

[3] Even if the application of the federal conflict of interest provisions were abundantly clear in a given situation, as the Conference has noted before: "The problem of post-employment activities of former Federal employees is too complicated, and the distinctions between permissible and impermissible conduct too fine, for fair and effective enforcement by criminal sanctions in most cases." Recommendation 79-7, 1 CFR § 305.79-7. If that is true with respect to full-time employees, it is even more so with respect to members of the transition team.

II. A TRANSITION WORKER SHOULD NOT BE REGARDED AS A SPECIAL GOVERNMENT EMPLOYEE

The federal conflict of interest statutes[4] restrict certain activity of both current employees and those who have terminated their service.

Special Government Employees.

The statute divides employees of the government into two categories, employees and special government employees.[5] A "special government employee" ("SGE") is an employee[6] who serves on a temporary or intermittent basis.[7] The classification of special government employee was created in 1962 to establish a status of federal employee as to which some, but not all, of the conflict of interest requirements would apply, the theory being that the full scope of restrictions were unduly burdensome when applied to temporary or intermittent employees.[8]

Who is a Special Government Employee?

A determination that someone is an employee or special government employee imposes significant restrictions upon that person's activities. The question, therefore, is whether a member of the transition team could be held to be an SGE. If he is regarded as providing services to the government, which will be taken up later, the question then becomes whether he is an "employee" or an "independent contractor."

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[4] 18 U.S.C. §§ 202-209.

[5] 18 U.S.C. § 202(a).

[6] Note, importantly, that the first requirement of being an SGE is that the person must be an employee of the government and not occupy some other relationship, such as an independent contractor.

[7] The statute defines an SGE as an employee "who is retained, designated, appointed, or employed to perform, with or without compensation, for not to exceed one hundred and thirty days during any period of three hundred and sixty-five consecutive days, or temporary duties either on a full-time or intermittent basis. . . ."

[8] Morgan, *Appropriate Limits on Participation by a Former Agency Official in Matters before an Agency*, 1980 Duke L. J. 1,9 (1980); Perkins, *The New Federal Conflict-of-Interest Law*, 76 Harv. L. Rev. 1113, 1123-7 (1963).

Someone who provides advice to the government -- typically called a "consultant" -- may serve the government as either an employee or as an independent contractor. The *Federal Personnel Manual* provides guidelines for determining whether an employee-employer relationship exists between a consultant and the government:[9]

> Ordinarily when an agency uses the advisory services of someone of consultant caliber, the agency creates an employee-employer relationship governed by this chapter. Pay for personal service usually indicates an employee-employer relationship, but the relationship also exists when service is unpaid. However, the facts in a situation govern whether the relationship exists . . . . Although not all the conditions usually associated with the relationship are present, an employee-employer relationship subject to this chapter usually exists when the person:
>
> 1) serves under the direction and supervision of a federal employee;
>
> 2) works in space and with equipment provided by the government;
>
> 3) has access to agency records and files;
>
> 4) analyzes for solution specific agency problems and functions and presents recommendations or reports;
>
> 5) ordinarily serves on more than one occasion on the same project, and may serve periodically for some time;
>
> 6) works on dates or at hours set by or required to be reported to the agency.

The primary test for determining whether someone is an SGE or an independent contractor is the degree of operational control or supervision exercised by the Government official for whom the services are being rendered: independence is the key.[10]

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[9] Chapter 304, "Experts and Consultants".

[10] Davis, *Special Government Employees: Application of Conflict of Interest Laws and Regulations*, Office of Government Ethics Conference (1981) at L-2.

APPLICATION OF THE GENERAL RULES TO THE TRANSITION.

Several of these criteria would point squarely to the transition team as being SGEs. Many of them will work in space and with equipment provided by the government. They certainly have access to agency records and files. They analyze agency problems and functions and present recommendations and reports, although they may not be involved in "specific" problems.

But, do they serve under the direction and supervision of a federal employee? Their loyalty, indeed their very reason for being, is to provide advice to the President-elect. They do not answer to a government employee or officer, let alone be supervised by one. Nor do they provide advice or services to the government as such. They provide it to the President-elect who occupies a singular status -- not quite private, but not yet part of the government. Thus, under generally applicable provisions, the transition team would not likely be regarded as SGEs.

PRESIDENTIAL TRANSITION ACT.

In addition, the matter has been addressed at least somewhat by statute. The Presidential Transition Act of 1963 provides:

> Notwithstanding any other law, persons receiving compensation as members of the office staffs under this subsection, other than those detailed from agencies, shall not be held or considered to be employees of the Federal Government . . . .[11]

To be sure, the transition team that goes out into the agencies may not be regarded as part of "the office staff," and the section only applies to those who are compensated under the Act. But, the intent behind the law appears to be that the President-elect is not part of the government itself but needs resources for "his preparation for the assumption of official duties,"[12] and that would certainly seem to be equally applicable to transition members who are not part of the office staff and who are not paid under the Transition Act. The thrust of the Act, therefore, accords with the application of the general rule that the transition team should not be regarded as SGEs.[13]

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[11] § 3(a)(2), published at 3 U.S.C. § 102 n.

[12] § 3(a).

III. THE FEDERAL CONFLICT OF INTEREST REQUIREMENTS

The federal conflict of interest statutes impose detailed and complex requirements on employees and former employees. They vary with respect to whether the person is a current or former employee, the extent to which the employee has or had authority over the issue in question, and whether the person is a regular or special government employee, and even in this case, the obligations vary. A relatively detailed review of the conflict of interest restrictions is contained in the Appendix. Inasmuch as these duties are not directly applicable to transition workers but do serve as an important analogy or starting point for recommended standards of conduct, they are described here in a general way.

GENERAL OR SPECIFIC ISSUES.

On the whole, the conflict of interest statutes that restrict the activities of government employees and former employees vary with respect to whether the issues involved are general (called "particular matters" in the statutes)[14] or specific (called "particular matters involving a specific party or parties" in the statutes).[15] General issues cover all types of discrete agency decisions, no matter how broad the effect, including rulemaking and matters of policy. In contrast, specific issues are more limited: they concern a proceeding that affects the legal rights or status of identifiable parties or a particular transaction between parties. Thus, for example, an employee's participating in the design of a program for training teenagers would be a general issue, but not a specific one. His participation in the decision as to whether or not to provide a particular applicant with funds would be a specific matter; it is also, of course, a general one.

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[13] This analysis demonstrates a cautionary note, however. A transition team member who has direct contact with an agency, especially if that person expects to assume a senior position in the agency after the inauguration, may be tempted to undertake additional responsibilities beyond those required for the transition. It may be that by doing so he would then be regarded as an SGE with respect to those duties, and the conflict of interest restrictions would apply.

[14] See the discussion in the Appendix, text accompanying nn. 55,56, for an elaboration on the term "particular matter."

[15] See the discussion in the Appendix, text accompanying nn. 57, 58, for an elaboration on the term "particular matter involving a specific party or parties."

RESTRICTIONS WHILE AN EMPLOYEE OR SGE.

Employees may not concurrently be paid by or represent others. An employee may not be paid by[16] nor represent anyone other than the government before a court or agency[17] concerning any general matter in which the government itself is interested. Thus, for example, any employee of the agency which is considering the training program above may not be paid by nor represent anyone with respect to that program.

SGEs may not be paid by or represent others as to specific matters. These restrictions apply to an SGE only with respect to specific matters in which the SGE has actually participated personally and substantially. But, if the SGE serves more than sixty days in a calendar year, the restrictions apply to all specific matters which are pending before his agency. An SGE who participated on an advisory committee with respect to the design of the program could represent an applicant for a grant under the program since he did not participate personally and substantially in the relevant specific decision. He could represent someone with respect to the program itself, as long as he did not have a financial conflict of interest, since the prohibition applies only to specific matters. If, however, the SGE worked more than sixty days during the year, he could not represent the party with respect to the application since it would be a specific matter pending in his agency. Note that under the first of these two sections, an SGE is prohibited altogether from being compensated by anyone other than the government for such matters, including counseling or advising clients in the privacy of his own office.

Financial conflict. An employee, including an SGE, is also prohibited from participating in any general matter in which he or a close relation has a financial interest. This restriction may be waived, however, if the employee discloses the conflict in advance and receives a written determination that it is not so substantial as to be likely to influence his official duties.

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[16] 18 U.S.C. § 203.

[17] 18 U.S.C. § 205.

RESTRICTIONS ON FORMER EMPLOYEES.

Employees, including SGEs, who leave government service are subject to three levels of restrictions on their activities.

Permanent ban on representation concerning specific matters in which employee participated. An employee, including an SGE, may **never** represent[18] anyone in an appearance before **any** agency or court with respect to any specific matter in which he participated[19] personally and substantially. Note that it is the contact with an agency or court that is prohibited here. This section does not restrict the former employee from counseling another party with respect to such an issue so long as he does not contact an agency or court with respect to trying to influence the decision, nor does it prohibit the former employee from representing someone in a general matter.

Two year ban on representation concerning specific matters under official responsibility. For a period of two years, a former employee may not represent anyone in an appearance before any agency or court with respect to any specific matter which was pending under his official responsibility within one year prior to his leaving. Under this section, for example, a former SGE who sat on an advisory committee that made recommendations for contracts to implement the teenage training program could not appear before an agency with respect to an application for a contract if the application had been submitted within one year before he left even if he had not acted on the matter himself. He could counsel others concerning the application, and he could appear before his old agency with respect to matters not under his authority before he left. And, indeed, he could represent others on general matters under his authority; thus, he could represent the same applicant with respect to a proposed change in the general rules.

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[18] "Represent" means "knowingly act[ing] as an agent or attorney for, or otherwise represent[ing a party], in any formal or informal appearance, or with the intent to influence, mak[ing] any oral or written communication on behalf of] a party before an agency or court. 18 U.S.C. § 207(a).

[19] For purposes of the conflict of interest statutes, "participate" includes "through decision, approval, disapproval, recommendation, the rendering of advice, investigation or otherwise." Thus, someone who analyzes a program and makes recommendations for new policies would be regarded as "participating" in the decision concerning those policies.

Two year ban on advising with respect to a specific issue in which senior official participated. In addition, senior agency officials are prohibited for two years after their departure from representing or advising others by personal presence before any agency or court with respect to any specific matter in which he participated personally and substantially. Under this section, the former high official may be physically present in the room but only as an observer. If he is present and provides advice concerning the matter, he has violated the duty. This restriction lasts for two years; the more general one above, however, continues to prohibit the official from ever representing anyone concerning such matters. What he gains after two years, is that he can sit in the hearing room and provide advice to a colleague.

One year ban on senior officials from contacting former agency. Senior agency officials, other than SGEs who serve less than sixty days, may not represent anyone in an appearance before their former agency with respect to any general matter which is pending before the agency. Under this section, the former executive is barred for one year from even contacting his former agency with respect to any matter, if the contact is intended to influence a decision. He may, however, represent someone with respect to such matters before other agencies or in court, and he may counsel clients concerning such matters so long as he does not contact his former agency.

PARTNERS OF EMPLOYEES.

A partner of an employee,[20] including an SGE, is prohibited from acting as the agent or attorney for anyone before any agency or court in connection with any general matter in which the employee participates or has participated personally and substantially.

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[20] This restriction applies only to partners of current employees. It therefore does not bar the partners of a former SGE from representing another party in a matter in which the SGE participated while in government service.

IV. OTHER DUTIES OF SGEs

Additional requirements have been imposed on SGEs by an Executive Order initially issued by President Johnson to provide "Standards of Ethical Conduct for Government Officers and Employees."[21] Since many of its duties for SGEs are relevant to transition workers, the appropriate section is set out here:

> PART III - Standards of Ethical Conduct for Special Government Employees
>
> Sec. 301. This part applies to all "special Government employees" as defined in Section 202 of Title 18 of the United States Code, who are employed in the Executive Branch.
>
> Sec. 302. A consultant, adviser or other special Government employee must refrain from any use of his public office which is motivated by, or gives the appearance of being motivated by, the desire for private gain for himself or other persons, including particularly those with whom he has family, business, or financial ties.
>
> Sec. 303. A consultant, adviser, or other special Government employee shall not use any inside information obtained as a result of his government service for private personal gain, either by direct action on his part or by counsel, recommendations or suggestions to others, including particularly those with whom he has family, business, or financial ties.
>
> Sec. 304. An adviser, consultant or other special Government employee shall not use his

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[21] Published at 18 U.S.C. § 201 n., 30 Fed. Reg. 6469 (May 8, 1965). It was subsequently amended in 1971 (36 Fed. Reg. 7831) and 1978 (44 Fed. Reg. 1055). Section 306 of the Order, which required financial disclosure, was repealed by Exec. Order 12,565, 51 Fed. Reg. 34437 (September 25, 1986); additional financial disclosure requirements were imposed by Part IV of that order.

> position in any way to coerce, or give the appearance of coercing, another person to provide any financial benefit to him or persons with whom he has family, business, or financial ties.
>
> Sec. 305. An adviser, consultant, or other special Government employee shall not receive or solicit from persons having business with his agency anything of value as a gift, gratuity, loan or favor for himself or persons with whom he has family, business, or financial ties while employed by the government or in connection with his work with the government.

Like the statutory provisions, the Order would not likely apply directly to the transition team, but also like the statute itself, it provides an analogy for the types of requirements to which the team needs to be sensitive.

The Office of Government Ethics has issued general requirements for employee responsibilities and conduct.[22] They are to be implemented by regulations issued by the individual agencies. Two are particularly relevant to this inquiry, although by their terms neither is directly applicable to an SGE:

> **Use of Government property**[23]
>
> An employee shall not directly or indirectly use, or allow the use of, Government property of any kind, including property leased to the Government, for other than officially approved activities. An employee has a positive duty to protect and conserve Government property, including equipment, supplies, and other property entrusted or issued to him.

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[22] 5 CFR Part 735.

[23] 5 CFR § 735.205.

Misuse of Information[24]

> For the purpose of furthering a private interest, an employee shall not ... directly or indirectly use, or allow the use of, official information obtained through or in connection with his Government employment which has not been made available to the general public.

The Ethics in Government Act requires senior level SGEs and such others as the President may designate to file a financial disclosure report.[25] The reports include: income in the form of dividends, interest, rent, and capital gains; other income, including honoraria; gifts of food, lodging, transportation and entertainment; other gifts; assets and liabilities; transactions involving certain assets; certain positions held in any corporation, firm, or business; and any arrangements or agreements with a former or future employer, and the identification of certain major clients.[26] These reports are extensive and require sufficient detail that they are the subject of frequent complaints as to both the time required for their completion and their intrusiveness. Given the limited duration of the transition team and its lack of direct authority, like the conflict of interest provisions, it would not seem necessary or appropriate to impose the full rigors of the financial disclosure provisions on them. Rather, as the legislation currently pending in Congress would do, a more limited disclosure as to the identity of the individual's private employer, if any, and the sources, if any, of funds that are supporting him during the transition.

V. RECOMMENDATIONS

Using the conflict of interest restrictions imposed on special government employees as an analogy and taking into consideration the special circumstances of the Presidential transition, the Committee recommends the following Standards of Conduct for members of the Presidential transition team who have access to non-public information:

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[24] 5 CFR § 735.206.

[25] §§ 201(f)(3), 207(a). The reporting requirements are contained in 5 CFR § 734.

[26] ACUS, *Federal Administrative Procedure Sourcebook*, 409 (1985).

No. 1. *Disclosure of Information.*

> A special transition team member shall supply the agency with a statement as to his or her present employment and the sources of funding which support his or her transition activities.

This is the standard contained in the currently pending legislation. It is less intrusive than that required of an SGE, but it will provide the agency and the public with critically important information: who is the transition employee's private employer and who is financing his participation in the transition effort.

No. 2. *Misuse of Inside Information.*

> A special transition team member shall not use, directly or indirectly, or permit others to use, official non-public information to further a private interest.

This is the same standard applicable to SGEs.

No. 3. *Financial Self-Dealing.*

> A special transition team member shall not take any action on a particular matter involving the federal agency which could have a direct effect upon a financial interest of the transition team member, his or her spouse, a family member, or any individual with whom the transition team member has a business, professional or close personal relationship.

This is the same standard applicable to SGEs.

No. 4. *Concurrent Representation in Agency Proceedings.*

> During the transition period, a special transition team member shall not advise or represent, with or without compensation, anyone in any particular matter involving a federal agency to which he or she has had access to non-public information. This restriction does not extend to the special transition team member's firm or organization, but the team member should advise his or her firm or organization to establish procedures to assure that

the team member does not participate in any way in any such agency proceeding

This is more restrictive than that applicable to SGEs, but less restrictive as to partners.

An SGE is prohibited only from being compensated by or representing another party with respect to specific issues -- particular matters involving a specific party or parties -- in which he participates personally and substantially as a government employee or, if the SGE is employed for more than sixty days, with respect to any matter pending before the agency. The concern addressed by this standard is that a transition worker who has access to confidential information may be perceived as having significant influence on the decisions of the agency generally, purely as a result of the special access, and not just with respect to specific issues in which he participates. This restriction is therefore triggered by access to non-public information and would, in addition, prohibit the transition worker from advising or representing another party with respect to any particular matter involving the agency -- including matters of general policy or rules. Thus, for example, during the transition, a transition worker with access to non-public information could not advise a client concerning a rulemaking or other policy matters, even if the confidential information to which he had access did not pertain to the relevant program within the agency. An SGE could, however, advise or represent another party concerning general policy matters or (if he worked less than sixty days) specific matters which were outside the scope of his authority.

On the other hand, this standard provides that the restrictions are not to be imputed to the transition member's partners or organization, although they are to be requested to establish screening procedures. The partners of an SGE may not act as the agent or attorney for any party in any particular matter in which the SGE has participated personally and substantially. In this case, for example, if a partner in a law firm is serving as an SGE and in that capacity makes policy recommendations concerning a new rule, his partners may not represent anyone in the associated rulemaking proceeding. In this recommended standard, the partners would be permitted to do so. That is because the transition continues for such a short period, the transition worker will not have any decisional authority with respect to the matter, and the transition worker is otherwise barred from advising with respect to the issue. It therefore appears that the risk of gaining undue influence is relatively slight, yet the potential cost of inhibiting qualified people from participating in the transition because their firm may be involved in some matter before the agency would likely be high.

No. 5. *Misuse of Government Property.*

> (a) A special transition team member shall not use federal property, including equipment and supplies, other than for purposes directly related to transition activities.
>
> (b) A special transition team member shall conserve and protect federal property entrusted to him or her.

This is the same standard applicable to SGEs.

No. 6. *Post-Transition Activities.*

> After the transition, a former special transition team member shall not advise or represent, with or without compensation, any person before an agency in any particular matter as to which he or she obtained official information not then available to the public and not made public prior to the request for advice or representation.

This restriction is similar to the two year ban applicable to senior agency officials who participated personally and substantially in the decision, except that it applies to general matters and is not limited to specific ones. Because the transition worker would not have any decisional authority nor any lasting institutional presence, as does a former senior official, it does not seem necessary or appropriate to bar him from participating in matters after the transition simply because he may have made recommendations concerning them during his tenure. On the other hand, it would continue to be inappropriate to use confidential information garnered as a result of the transition, and hence this standard would bar the former transition worker from advising or representing any party before the agency, including issues of general policy so long as the information is not publicly available; once the public at large has the information, the restrictions are removed. There is no precise analog in the conflict of interest statutes for this standard, although employees and SGEs are banned generally from using confidential information for personal ends; this is a specific application of that general requirement.

APPENDIX

ANALYSIS OF THE FEDERAL CONFLICT OF INTEREST REQUIREMENTS APPLICABLE TO FEDERAL EMPLOYEES AND SGEs

RESTRICTIONS ON CONCURRENT REPRESENTATION.

A federal employee is prohibited from receiving compensation except as provided by law for the proper discharge of his duties "in relation to any . . . particular matter in which the United States is a party or has a direct or substantial interest . . . ."[27] Moreover, a federal employee may not act as an agent or attorney for anyone before any agency or court "in connection with any . . . particular matter" in which the United States has a "direct and substantial interest."[28] A violation of these restrictions may result in a fine of not more than $10,000 or imprisonment for not more than two years, or both.

These requirements apply to a lesser degree to special government employees. They apply to an SGE "only in relation to a particular matter involving a specific party or parties[29] . . . in which he has at any time participated[30] personally and substantially" as an SGE.[31] For example, an SGE who participates in the awarding of a federal contract to one competitor over another may not represent the losing contractor in an action against the United States for rescission of the award. On the other hand, if he participated in the design of the overall program that was to be implemented by a series of contracts, he may represent a firm with respect to obtaining a contract

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[27] 18 U.S.C. § 203(a).

[28] 18 U.S.C. § 205.

[29] For an analysis of the distinction between the terms "particular matter" and "particular matter involving a specific party or parties", see pages 21-22. Basically, "particular matter" includes rulemaking and general policy issues, no matter how general the effect. The term "particular matter involving a specific party or parties" typically involves a specific proceeding affecting the legal rights of the parties or an isolatable transaction or related set of transactions between identifiable parties; it does not include rulemaking or the formulation of general policy.

[30] For purposes of the conflict of interest provisions, the term "participates" includes "through decision, approval, disapproval, recommendation, the rendering of advice, investigation or otherwise."

The full rigor of these restrictions apply, however, to an SGE who serves for more than sixty days out of a year regarding any matter pending before the agency which the SGE serves.[32] Thus, for example, an SGE who works 61 days in a calendar year may not be retained[33] to even make an inquiry concerning the status of a specific proceeding such as the award of a contract or permit. The SGE could, however, inquire about and encourage the shaping of a general policy or represent a party in a rulemaking proceeding.

FINANCIAL CONFLICTS.

An employee or SGE is prohibited from participating personally and substantially in any "particular matter" before an agency or court in which the employee to his knowledge has a financial interest.[34] The restriction applies equally to financial interests of the employee, "his spouse, minor child, partner, organization in which he is serving as officer, director, trustee, partner or employee, or any person or organization with whom he is negotiating or has any arrangement concerning prospective employment.[35] Thus, without a waiver, an SGE may not make recommendations concerning general policy matters, such as a proposed rule, if that rule or policy would benefit his private employer. As a specific example, a feedlot operator may not make recommendations to the Food and Drug Administration concerning the desirability of the use of low levels of antibiotics in animal feeds, since presumably the policy, whether or not it were adopted, would affect his operating costs.[36]

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[31] 18 U.S.C. §§ 203(c)(1), 205.

[32] Id. Section 205 contains a waiver provision for an SGE who works for an outside organization under a contract with the United States. This provisions states, "nothing herein or in Section 203 prevents a special government employee from acting as agent or attorney for another person in the performance of work under a grant by, or in contract with or for the benefit of, the Unites States provided that the head of the department or agency concerned with the grant or contract shall certify in writing (to be published in the Federal Register) that the national interest so requires." 18 U.S.C. Section 205. This exception permits an SGE to assist a government contractor in the performance of a government contract. Other waiver provisions apply with respect to non-compensated representation in disciplinary proceedings. An employee may also represent his family except in matters in which he participated personally and substantially, provided the official responsible for his appointment to his position approves.

[33] If the SGE were paid for the services, he would violate § 203. Even if he were not paid but nonetheless acted as the agent or attorney for someone else, he would violate § 205, except for directly personal relationships.

This prohibition does not apply if the employee or SGE fully discloses to the proper government official the nature of his interest and receives "in advance a written determination that this interest is not so substantial as to be deemed likely to affect the integrity of the services which the government may expect from such officer or employee."[37] The government may also exempt by general rule certain types of financial interest which are remote or inconsequential.[38]

PAYMENTS FROM OTHER SOURCES.

Employees may not receive payment for their service as federal employees from any source other than the United States government.[39] The section does not apply to special government employees, however.[40]

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[34] 18 U.S.C. § 208(a). The penalty for a violation is a fine of not more than $10,000 or not more than two years imprisonment, or both.

[35] Id.

[36] Office of Legal Counsel, *Memorandum Opinion for the Chief Counsel, Food and Drug Administration*, No. 78-37 (1978).

[37] 18 U.S.C. § 208(b).

[38] Id.

[39] 18 U.S.C. § 209.

[40] § 209(c) provides:

> This section does not apply to a special Government employee or to an officer or employee of the Government serving without compensation,

RESTRICTIONS ON POST EMPLOYMENT ACTIVITIES.

Three levels of conflict of interest restrictions apply to government employees, including SGEs, who leave government service.[41]

Former government employees, including SGEs, are forever prohibited from acting as "agent or attorney or otherwise representing any person . . . in any . . . appearance before or, with the intent to influence, mak[ing] any oral or written communication" to any agency or court with respect to[42] any "particular matter involving a specific party or parties" in which they participated personally and substantially while in government service.[43] Thus, a former government employee, including an SGE, may never represent a party before any agency or court concerning a specific adjudicatory-type proceeding in which he participated, including through the rendering of advice or recommendations. He may counsel clients concerning such matters, however, so long as he does not communicate with a government decision maker. The ban does not reach providing advice on general policy matters or rules.

Former government employees, including SGEs, are also prohibited for two years from acting as the agent or attorney or otherwise representing any person in any appearance before or, with the intent to influence, communicating with any agency or court with respect to any "particular matter involving a specific party or parties" in which they participated personally and substantially and "which was actually pending under [their] official responsibility as an officer or employee within a period of one year prior to the termination of such responsibility".[44] Thus, even

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whether or not he is a special Government employee. . . .

[41] 18 U.S.C. § 207.

[42] The statutory phrase is "in connection with any judicial or other proceeding, application, request for a ruling or other determination, contract, claim, controversy, investigation, charge, accusation, arrest, or other particular matter involving a specific party or parties in which the United States or the District of Columbia is a party or has a direct and substantial interest". § 207(a)(2).

[43] § 207(a).

[44] 18 U.S.C. § 207(b)(3)(i).

if the SGE did not "participate personally and substantially" in making the decisions, he may not represent anyone else before any agency or court for two years on that matter if it was pending under his official responsibility within the year prior to his leaving. For example, if an SGE were hired to review applications for housing subsidies, for two years after leaving the government service, he could not represent anyone[45] who had an application pending, even if no decision were made on it during his tenure.

Other restrictions apply to employees on the Executive Schedule and those involving "significant decision-making or supervisory responsibility, as designated . . . by the Director of the Office of Government Ethics, in consultation with the department or agency concerned."[46] For two years, they may not represent, aid, counsel, advise, or assist in representing any other person by personal presence at any formal or informal appearance before an agency or court concerning any matter in which they participated personally and substantially.[47] In this case, high officials who participated personally and substantially in an adjudicatory-type proceeding[48] may not be physically present (other than as strict observers; they may not "advise" anyone with respect to the issue) before an agency or court concerning that matter for a period of two years. They may, however, provide advice and counsel on the matter in the privacy of their own offices.

Moreover, for one year after the termination of employment such a senior individual, except SGEs who serve less than sixty days in a calendar year, may not act as an agent or attorney nor otherwise represent anyone in any appearance before his agency[49] in a "particular matter" in which the agency has a direct and substantial interest.[50] Under this provision, these officials may not, for one year, represent anyone on any issue which is pending in the agency by appearing before the agency nor may he otherwise contact his former agency with the intent of influencing the decision. He may, however, represent parties before other agencies or in court, and he may counsel clients concerning those issues so long as he does not contact his former agency.

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[45] Representation here means by appearance before the agency or communicating with it -- even if a different agency than the one for which he worked or in judicial review of an agency action. It does not mean that the former employee cannot counsel others as to such matters so long as he does not contact the government.

[46] 18 U.S.C. § 207(d)(1)(C). The list is contained in 5 CFR § 737.33.

[47] 18 U.S.C. § 207(b)(3)(ii).

[48] It seems easier, if perhaps a bit inaccurate, to use this term as opposed to "particular matter involving a specific party or parties."

[49] The Director of the Office of Government Ethics may limit these restrictions to permit a former senior official other than the agency heads or other specific officials to appear before a separate

PARTNERS OF EMPLOYEES.

A partner of an employee, including an SGE, may not serve as the agent or attorney before any agency or court in any "particular matter" in which the employee participates or has participated personally and substantially.[51]

BAN ON APPEARANCES FOR VIOLATIONS.

If the agency head finds, after notice and opportunity for hearing, that a former employee has violated these provisions, he may prohibit the former employee from making any appearance before the agency or submitting any oral or written

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division of the agency having separate and distinct subject matter jurisdiction if he determines that there exists no potential for undue influence or unfair advantage based on past government service. 18 U.S.C. §§ 207(d)(1)(C), (e). The regulations setting out the distinct sub-programs is contained in 5 CFR §§ 737.31, 32.

[50] 18 U.S.C. § 207(c). The penalty for violating this Section is a $10,000 fine or imprisonment for not more than two years, or both.

This one year ban does not apply to former employees who are elected officials of a state or local government or an accredited degree granting institution of higher education, or a hospital or medical research organization. § 207(d) (2). An agency may also exempt a particular individual from the one year ban if the individual has outstanding qualifications in a technical discipline and the national interest would be served by his appearance. § 207 (f).

[51] 18 U.S.C. § 207(g). Importantly, this restriction applies only to partners of current employees: "Neither the Act nor these regulations impute the restrictions on former employees to partners or associates of such employees." 5 CFR § 737.21(b).

communication to the agency on a pending matter for a period of up to five years.[52]

"PARTICULAR MATTER" VERSUS "PARTICULAR MATTER INVOLVING A SPECIFIC PARTY OR PARTIES".

The statutes distinguish between "particular matters" and "particular matters involving a specific party or parties." For example, §§ 203(a), 205, 207(b), 207(g) and 208 restrict participation in "particular matters" whereas §§ 203(c), 205 (as it applies to SGEs), 207(a), and 207(b) are limited to "particular matters involving a specific party or parties." The question therefore becomes, is there a difference and if so, what is it?[53]

As one of the members of the advisory panel appointed by President Kennedy to recommend changes in the federal conflict of interest laws explained:

> The significance of the phrase "involving a specific party or parties" must not be dismissed lightly or underestimated. [The statute] discriminates with great care in its use of this phrase. Wherever the phrase does appear in the new statute it will be found to reflect a deliberate effort to impose a more limited ban and to narrow the circumstances in which the ban is to operate.[54]

The first issue to be addressed, therefore, is what is a "particular matter." The Office of Legal Counsel found that the term applies "to any discrete or identifiable decision, recommendation, or other matter even though its outcome may have a rather broad impact."[55] The Director of Office of Government Ethics recently explained to Congress that OGE and the Department of Justice interpret the term "particular matter," without further qualification, as including "rulemaking and general policy matters, and extend[ing] to all discrete matters that are the subject of agency action, no matter how general the effect."[56]

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[52] 18 U.S.C. § 207(j).

[53] For example, one observer who was present at the creation of the current statute appears to think the language is a difference without meaning: "it seems doubtful that these discrepancies carry any substantive difference." Perkins, *supra* n. 8, at 1127. He points out that the phrase "involving a specific party or parties" was added by the Senate Judiciary Committee at the request of the Department of Justice. At n 51.

[54] B. Manning, *Federal Conflict of Interest Law* (1964) at 204.

The panel consisted of Judge Calvert Magruder of the First Circuit, Dean Jefferson Fordham of the University of Pennsylvania Law School, and Professor Bayless Manning. Morgan, supra, at 9.

On the other hand, the restrictive phrase "particular matter involving a specific party or parties" does not include "general rulemaking, the formulation of general policy or standards, or other similar matters."[57] Indeed, the regulations of the Office of Government Ethics define the highlighted term as meaning:

> Such a matter typically involves a specific proceeding affecting the legal rights of the parties or an isolatable transaction or related set of transactions between identifiable parties. Rulemaking, legislation, the formulation of general policy, standards or objectives, or other action of general application is not such a matter. Therefore, a former Government employee may represent another person in connection with a particular matter involving a specific party even if rules or policies which he or she had a role in establishing are involved in the proceeding.[58]

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[55] OLC, *supra* n. 36.

[56] Testimony of Frank Q. Nebeker, Director, Office of Government Ethics, before the Senate Committee on Governmental Affairs on The Federal Advisory Committee Act, April 19, 1988 at 9.

[57] Memorandum of the Attorney General Regarding Conflict of Interest Provisions of Public Law 87-849, 18 U.S.C. § 201 n.

[58] 5 CFR § 737.5(c).

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-2

CONTRACTUAL INDEMNIFICATION OF GOVERNMENT CONTRACTORS

by

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December 1, 1988

CONTRACTUAL INDEMNIFICATION OF GOVERNMENT CONTRACTORS

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December 1, 1988

CONTRACTUAL INDEMNIFICATION OF GOVERNMENT CONTRACTORS

I. INTRODUCTION

The subject of indemnification of government contractors is of continuing interest because it is closely connected to the procurement process, the process by which government obtains the goods and services to perform its governmental function. It is of great interest to government contractors and their attorneys, as well as to plaintiff's lawyers and to their clients who have an interest in the recovery of damages for injuries and damages suffered in accidents caused by products and services supplied by government contractors. There is also a more general interest in public protection and in the protection of victims of mass injuries that may result from catastrophic accidents in government contracts.

Another reason for renewed interest in the subject has been the recurrence of newspaper articles and other media reports on a variety of dangerous government activities, and of injuries by high technology products manufactured pursuant to government specifications. Such high risk government contracts include outer-space activities of a military and civilian nature. The recent space shuttle disaster has brought issues of governmental and manufacturer responsibility into high relief, and has made issues of liability a subject of wide popular discussion. The publicity given to the Agent Orange litigation and to its on-going settlement have alerted the public to the possible peacetime consequences, liabilities growing out of past government action related to military operations. The continuing concerns over the safety of nuclear power have not been put to rest. The tenfold increase in government indemnification under the most recently passed amendment of the Price-Anderson Act indicates an awareness of the dimension of nuclear hazards. Fears of the nuclear hazard have also been fed by recent attention to the radon gas problem, and governmental efforts to find a place to dispose of radon-polluted soil have focused attention on government responsibility. The issue of finding a permanent disposal place for nuclear waste gets regular media attention, and also raises recurring thoughts of government responsibility and indemnification.

Other reminders of government and contractor liability are the news stories involving propellants for outer-space rocketry, and accounts of vast military defense systems. The area of biological investigation involving gene splicing, including plant research by the Department of Agriculture with genetically altered organisms, has also created anxieties.

There is no need for a full catalogue of risky government activities and of products and substances used or contracted for by government that may present risks to the public. Some newly emerging government involvements as testing for the AIDS virus, and contracting for the development of AIDS immunizing agents put the government and its contractors at substantial risk for which government indemnification is likely to be sought.

The greater hazards involved in the performance of many government contracts create greater needs for government indemnities and they also create the context for other legal and economic developments. Some of these developments, such as the government contract defense[1] and the "*Feres*"[2] rule seem to relieve government contractors of liability, other aspects of the law of torts place government contractors at considerable risk. Many government contracts involve activities which may be regarded as unusually hazardous, giving rise to the application of strict liability. What is true of potentially extra-hazardous activities under government contract is also true with respect to products produced under government contract, particularly when it is asserted that a product is defective in design. Under the usual rules of product liability,[3] manufacturers are strictly liable for design defects, and this poses a risk even though they may seek protection under the "government contract defense."

Another important element in the current interest in government indemnification is the on-going and much discussed crisis in insurance availability at reasonable rates. Whether or not there is a true insurance availability crisis is probably less important for current purposes than industry and popular perceptions relating to the matter. The industry concern over availability of insurance at affordable rates, and the popular perception that without such coverage injured members of the public will not be able to recover for their injuries contributes to the perceived need to provide for indemnities in government contracts. It is likely, therefore, that with the greater hazards in government contract activities there is greater pressure to secure indemnities contractually, because contractors find it increasingly difficult to secure indemnification through litigation, or to obtain coverage through insurance.

II. RECENT DOCTRINAL CHANGES IN THE LAW OF GOVERNMENT LIABILITY WHICH LIMIT THE RANGE OF FEDERAL OBLIGATIONS

When there are fewer opportunities to succeed in litigation against the government when a third party is injured, it may become more important to secure indemnification in advance. The liability of the government has always been narrowly limited by sovereign immunity.[4] Thus, indemnity can only be sought as a remedy when the claim on which it is based arises in a limited area in which sovereign immunity does not apply. The United States has waived sovereign immunity in the

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[1] See text at 7 *infra*.

[2] Feres v. United States, 340 U.S. 135 (1950).

[3] *Restatement of Torts* §4.02A.

[4] Cohens v. Virginia, 19 U.S. (6 Wheat) 264, 380 (1821); United States v. McLemore, 45 U.S. (4 How.) 284 (1846).

Federal Torts Claims Act,[5] The Federal Employees' Compensation Act,[6] and in a small number of other laws which expressly provide for government liability or indemnification. The wider the area of sovereign immunity, the narrower is the area in which a claim for indemnification can be made.

While government contractors have been involved in more government contracts, the government's immunity from law suits has also been extended to government contractors under a variety of theories. The most far-reaching of these theories is the government contract defense.[7] Briefly, it holds that the contractor will not be liable when it has acted in full compliance with government contract specifications. There is also the "contract specification defense," which applies to private parties who order products to their design specification. When there is a design defect, the injured third party can look to the principal who drew the specifications. In this situation the rule of respondeat superior normally applies, except that when the superior who drew the specifications is the government which is protected by sovereign immunity. Unless the contractor has deviated from government specifications, the contractor will not be liable to third parties who have suffered injuries, and the contractor will have no reason to look for indemnification. The third party, who has suffered injuries, can not recover from the contractor, and must bear the cost himself, unless he has an action against the government, and unless the government has waived sovereign immunity, as under the Federal Tort Claims Act.

The decisions that have provided the framework for the current discussion of the government contract defense -- and, indirectly, for the current discussion of contract indemnities -- are Feres v. United States,[8] Stencel Aero Engineering Corp. v. United States,[9] and McKay v. Rockwell International Corp.[10] The Feres case involved an action under the Federal Tort Claims Act on behalf of a serviceman killed while on active duty. He perished in a fire in a barracks; negligence was alleged because the barracks were allegedly known to be unsafe and there was no fire guard. The Court held that the United States is not liable under the Federal Tort Claims Act for injuries to members of the armed forces on active duty resulting from the negligence of others.

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[5] Federal Tort Claims Act, ch. 753, 60 Stat. 842 (1946); 28 U.S.C. §§2672-80 (and other scattered sections of the U.S.C.).

[6] 5 U.S.C. §7902 et seq.

[7] First developed in Yearsley v. W. A. Ross Construction Co., 309 U.S. 18 (1940), the government contract defense has been the subject of much recent legal literature. E.g. Zollers, Rethinking the Government Contract Defense, 24 Am. Bus. L. J. 405 (1986); Souk, Government Contracts and Tort Liability: Time for Reform, 30 Fed. Bar News & J. 74 (1983); Note, (M.K. Sales) Government Contract Defense: Sharing the Protective Cloak of Sovereign Immunity After McKay v. Rockwell International Corp. 3 BAYLOR L. REG. 181 (1985); Note (G.L. Berenstein), An Interpretation of the Feres Doctrine After West v. United States and In re "Agent Orange" Product Liability Litigation, 70 Iowa L. Rev. 737 (1985); Note, (J. D. Pelletier), Government Contract Defense: Should Manufacturer Discretion Preclude Its Availability? 37 Maine L. Rev. 187 (1985); Note (B. E. Bagelman), The Government Contract Defense and Manufacturers of Military Equipment: McKay v. Rockwell International Corporation, 21 Houston L. Rev. 855 (1984); Note (R. A. Roth), The Essence of the Agent Orange Litigation: The Government Contract Defense, 12 Hofstra L. Rev. 983 (1984); Note (R. A. Pelletier, Jr.), Liability of a Manufacturer for Products Defectively Designed by the Government, 23 Boston College L. Rev. 1025 (1982).

The reach of the holding was expanded in the Stencel case, in what has come to be known as the "Feres-Stencel doctrine." In Stencel, a National Guard officer was injured while on active duty when the ejection system of his aircraft malfunctioned during a mid-air emergency. The ejection system had been manufactured by Stencel on government contract specifications. The injured National Guard officer, though in receipt of a military pension, sued both the U.S. and Stencel, and Stencel crossclaimed against the U.S. The majority of the Court, per Burger, C. J. held that plaintiff's claim against the U.S. was barred by the Feres rule -- because it was a claim for injuries while in active service, and that Stencel's crossclaim was barred because such an action would circumvent the Feres rule, and would be equally disruptive of military discipline by calling for second-guessing of military orders. The dissent by Marshall, J., joined by Brennan, J. found no such disruption of military discipline in the third party action.

A further development in McKay v. Rockwell International Corp. seems to extend the protection of government contractors with respect to design defects, but the full reach and authority of this 9th circuit decision has caused great concern among government contractors and in Congress. In two separate incidents Navy pilots were killed after ejecting from burning RA-5C aircraft. The cause of the injuries appeared to be the defective ejection equipment manufactured to government specifications, Rockwell had warned the U.S. of errors in the specifications and of the resulting dangers, which were known to Rockwell but not to the U.S. Applying the Feres-Stencel doctrine, the court found no liability against the government and no liability against the contractor, because if military suppliers were held liable for defective designs (under Restatement §4.02A) then this would compel the courts to review military decision. The question of whether Rockwell was required to accept the government specifications was not discussed in the opinion. The case is frequently discussed in the context of Lockheed Aircraft Corp. v. United States,[11] where the Court permitted an indemnity action where the responsibility of the U.S. in an air crash was clear. The issue in that case was the alleged bar of indemnity actions under the exclusive liability provisions of the Federal Employees' Compensation Act.

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[8] 340 U.S.C. 135 (1950).

[9] 431 U.S. 666 (1977).

[10] 704 F.2d 444 (9th Cir. 1983) cert. denied, 104 S. Ct. 711 (1984).

[11] 460 U.S. 190 (1983).

The cases referred to appear to result in contractor protection especially in the area of contract specifications of product design. They appear to disquiet contractors because of the concern that government immunity appears to be absolute, while contractors may be at some risk for failure to follow specifications, or failure to have the government heed their corrections in design.[12]

Claims involving indemnity issues involve three parties: the government, the contractor, and a third party which has been injured or hurt in consequence of the performance or misperformance of the contract. While some rules of the law of torts as applied to government contracts may relieve both the government and the contractor from obligations, the question of the appropriateness of letting the third party victim bear the damages has not always received the attention it deserves. Thus, issues of government indemnity have grown in importance as the potential of government contracts to cause mass injuries has grown. This has increasingly posed an issue for legal reform.

The Current Law of Government Indemnification

Current Rules Relating to Indemnities, Generally

The Common Law of Indemnity

This paper deals primarily with the contractual indemnification of government contractors, i.e. with the statutory authorizations to enable government departments and agencies to include promises to indemnify in some of their contracts. It is the purpose of this part of the paper to place contractual indemnification in the general setting of tort law, where indemnities are remedies sought by litigation.

An understanding of the common law of indemnity is necessary to understand the law of indemnification of government contractors. Indeed, it is not a matter of historical background, but it is actually the law which applies in the majority of government indemnity cases which are currently litigated. Many of these cases involve actions under the Federal Tort Claims Act, which is federal law and defines federal liabilities for tortious conduct by the government, its agents or employees. What constitutes such tortious conduct for which liabilities may be asserted is defined by the applicable state common law, and the question of the liability of the government for the tortious conduct of its contractor is also defined by the appropriate state law of remedies for the particular tortious conduct. Thus, when the federal government contracts for the performance of a service, and the contractor performs the service in such a way as to injure a third party, the liability of the contractor to the third party is defined by the substantive law of torts of the state, and the question of federal liability is determined under the Federal Tort Claims Act.[13] But whether the remedy of indemnity is applicable will be determined by the law of the state that determines substantive liability in the first instance.[14] Since there is no federal common law of indemnity, the common law of indemnity of any of the several states whose law may apply to the case will determine government liabilities.[15]

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[12] E.g. Statement of T. Richard Brown, Vice President, Law Department, TRW Inc., Hearing fore the Senate Committee on the Judiciary, 99th Cong., 1st Sess. on S. 1254, at p. 48 (June 11. 1985).

Although the law of indemnity will have different application in different states, in general the following rules apply. When two parties are liable for injuries to a third, indemnity refers to a full reimbursement to the one who has discharged the common liability. Indemnity could be granted to a party who was held responsible solely by imputation of law because of a relationship to the actual tort feasor. Thus, when an employee is directed to do an act not manifestly wrong and he is then held liable for such an act by a third party, he may seek indemnity from the employer who employed him to engage in the particular activity.[16] In theory, at least, if the injured party sues the employer and the employer responds in damages, the employer may then be entitled to obtain indemnity from his employee. It has been noted that such cases of indemnity are more theoretical than real, but actions by employers of independent contractors are not uncommon.[17] On the other hand, when the employer is the U.S. Government, and the employee or contractor is a substantial company that has failed in its obligations under the contract, a government indemnification claim against such a company will be brought. Prosser cites a number of other instances where indemnity may be allowed under common law, but comments that it is difficult to predict exactly when indemnification will be imposed, because it is usually based on the equities of the parties' relationship and the conduct involved.[18]

Cases in which indemnification is sought as a remedy commonly involve situations in which the plaintiff has been injured or damaged by a number of tort feasors, standing in a variety of relationships to each other and to the victim. At a time when contributions among tort feasors was not available under the common law, indemnity provided a remedy by seeking out a defendant who in the view of the court bore the major part of the responsibility and could properly be charged with the entire amount of the damages. As long as contribution among tort feasors was barred, indemnity provided an all or nothing remedy. When contribution among tort feasors became acceptable in a majority of jurisdictions and when comparative negligence was adopted by statute in most of the states, indemnity as a remedy lost a great deal of its significance, and it is applied far less frequently.[19] It is probably fair to say that indemnity as a remedy has retained its importance in the government contract field, but in few others. By and large, treatises and course books on torts currently give very limited space to indemnity, and the most recent, 1987 edition of THE LAW OF TORTS by Harper, James and Gray treats indemnity as part of a general discussion of "Contribution and Indemnity."[20]

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[13] 28 U.S.C. §§2672-80 (and other scattered sections).

[14] Id.

[15] E.g. Stencel Aero Engineering v. United States supra, where the indemnity claim was based on the law of Missouri, 431 U.S. at 668, note 3.

[16] PROSSER & KEETON 341 (5th ed. 1984).

[17] 3 HARPER, JAMES & GRAY §10.2 (2d Ed., 1986).

[18] PROSSER & KEETON 343 (5th ed., 1984).

The Restatement of Torts (Second) §886B(1) states that "if two persons are liable in tort to a third person for the same harm, and one of them discharges the liability of both, he is entitled to indemnity from the other if the other would be unjustly enriched at his expense by the discharge of the liability." The section of the Restatement indicates instances in which indemnity is granted under this principle. The instances enumerated include independent contractors being vicariously liable for the conduct of the indemnitor, instances of agents following the direction of a principal, and instances where the indemnitor supplies a defective chattel or performs defective work as a result of which both are liable to a third person.[21]

The comments to the Restatement rule state that "The basis for indemnity is restitution, and the concept that one person is unjustly enriched at the expense of another when the other discharges liability that it should be responsibility to pay."[22] It should be noted that although the Restatement and other authorities regard restitution and unjust enrichment as the basis of indemnity, it is clear in many of the examples given in the Restatement itself that courts do not necessarily look to restitution and unjust enrichment in particular cases, but decide on the basis of past decisions or on the basis of an ad hoc determination of the equities. Indeed, it seems that in many instances courts rely on the remedy of indemnity as a last resort, when neither contribution nor joint liability is available, and when there appears to be a basic unfairness in having the defendant as the sole responsible party.[23] Implicit in the courts determination to impose indemnity is also the sense of the court that the indemnitor is in a better position to prevent the injury, and even more often, that the indemnitor is better able to pass along the cost and to distribute the economic burden than is the indemnitee.

The common law of indemnity seeks to resolve a recurring issue of responsibility: when a government contract results in injury or damage to a third party, who should bear the risk of liability, the government or the contractor? That question is posed, too, when legislation is considered to authorize the grant of contractual indemnity. In addition to the issues of fairness and insurability, there are other major issues relating to the needs of government to have contractors bid on dangerous though necessary products and services, and relating to the need to protect against catastrophic injuries from government contracts that might not only destroy a major company and its needed productive capacity, but that might also create vast numbers of personal injuries and huge damages beyond the capacity of any private contractor or insurer.

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[19] Id. at 344. HARPER, JAMES & GRAY, §10.2.

[20] Id.

[21] Id., §886B(1)(d),(e).

[22] Comment c.

[23] Compare PROSSER & KEETON, text at N. 18 supra.

III. CURRENT STATUTORY BASIS FOR INDEMNITIES FOR FEDERAL CONTRACTORS

There is no legislation in the United States which provides generally for indemnities for government contractors. There are, however, specific statutes which provide for indemnities for limited categories of government contracts under certain limited conditions. This patchwork of legislation has been developed in response to specific needs, and the very nature of these diverse pieces of legislation show that they were not developed in response to a general plan to provide for indemnities, but rather grew up in response to particular hazards created by government contracts. In some instances, too, contractual indemnities were authorized by legislation when there was a congressional judgement that indemnification was necessary to encourage contractors to undertake activities for the government which would expose them to greater risks than ordinary commercial or industrial activities that could be protected by private insurance.

The current debate over the extension of indemnities in government contracts must be seen in the light of the past history of the field. Persons who argue against the passage of legislation to create broad indemnity authorizations, frequently members of particular agencies and departments, are likely to rely on the past history to show that broad authorizations for indemnities are not necessary, because in the past the government has always been able to provide indemnities for specific purposes whenever a significant and well-defined need could be shown. The proponents of broad indemnity legislation are likely to point to existing narrow indemnity legislation to assert that the current patchy structure is inadequate to respond to current developments in a flexible fashion, and that it does not allow the government to provide indemnities in contracts for newly emerging areas, areas which cannot be comfortably subsumed under current legislation. When indemnities are not authorized, it has been suggested, potential bidders in hazardous new fields are likely to withhold bids, rather than to undertake the lengthy and laborious process of persuading Congress to authorize indemnification for such new areas as projects involving gene splicing and DNA research, projects involving the development of tests or immunizing agents for AIDS, or projects involving new methods for reducing the risk of removal of asbestos insulation from structures.

Contracts for Research and Development for Military Departments -- 10 U.S.C. §2354

A limited authority for contractual indemnity is contained in Chapter 139 of Title 10 of the U.S. Code; Section 2354 provides for indemnity for contractors involved in research and development contracts for a military department. The original law was passed in 1952, and applies only to contracts let by the Department of Defense and the Armed Services, unlike the later National Defense Contract Act which also covers contracts by other agencies, and which defines the availability of indemnity by activity and not solely by departments engaged in defense.[24] Another even more stringent limitation is the restriction of indemnities to "contracts for research and development or both."[25] Thus, the indemnity will be available for risks of the research and development of a new weapons system, but not for its regular production. Moreover indemnity may only be provided for risks which the contract defines as unusually hazardous.[26] Indemnity for research and development activities is available only to the extent claims or losses are not covered by insurance.[27]

The provisions relating to contracts for research and development for a military department have been extended to cover contracts for research and investigation by the Secretary of HHS through the U.S. Public Health Service.[28]

National Defense Contracts Act -- Pub. L. No. 85-804

The statutory authorization of broadest application for contractual indemnities is the National Defense-Contracts Act, P.L. 85-804, 50 U.S.C.A. §1431, (1958) which must be read together with the executive order promulgated pursuant thereto, namely Executive Order No. 10789. The authorizing language is as follows:

> The President may authorize any department or agency of the Government which exercises functions in connection with the national defense, acting in accordance with regulations prescribed by the President for the protection of the Government, to enter into contracts or into amendments or modifications of contracts heretofore or hereafter made and to make advance payments thereon, without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense ...[29]

The statute then puts limitations on the obligations which may be incurred without approval by high level officials within the department, and provides that no obligations in excess of 25 million dollars may be incurred without providing an opportunity to the Armed Services Committee of the Senate and the House to disapprove. (The 1983 decision of the Supreme Court in Chadha has invalidated such legislative veto provisions.)[30]

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[24] 10 U.S.C.A. §2354(a) (West 1983).

[25] Id.

[26] Id.

[27] Id.

[28] Infra, text at N. 52.

[29] 50 U.S.C.A. §1431 (West Supp. 1987).

It is noteworthy that the legislation itself provides a single test, namely whether or not the contracts, contract modifications and advance contract payments "facilitate the national defense." It is also significant that although the law is regarded as the broadest available authorization for contract indemnification, the terms "indemnification," "indemnity" or "contractual indemnity" do not appear in the legislation at all having been supplied as one of the purposes by the Executive Order which was promulgated immediately upon passage of the legislation.[31]

The Executive Order authorizes the Department of Defense to enter into contracts and contract modifications, and to make advance payments, "within the limits of the amounts appropriated and the contract authorization provided therefore," whenever, in the opinion of the Secretary of Defence or of the chiefs of particular services or their duly authorized representatives "the national defense will be facilitated thereby."[32]

The Executive Order then proceeds to define the authority to indemnify. First, it is made clear that the limitation to the amounts appropriated and the contract authorization provided "shall not apply to contractual provisions which provide that the United States will hold harmless and indemnify the contractor against any of the claims or losses set forth in subparagraph B."[33] But the exception from the limitation relating to amounts appropriated and contract authorization provided is to apply only to claims or losses arising out of or resulting from risks that the contract defines as unusually hazardous or nuclear in nature.[34] The contractual provision is to be approved in advance by an official at the level, or above that of the secretary of a military department, and such a contractual provision may require the indemnified contractor to provide financial protection of a type and in the amount determined to be appropriate under the circumstances by the approving official.[35] In making this determination, the official is to take into account the availability, cost and terms of private insurance, selfinsurance, other proof of financial responsibility, and Workman's Compensation Insurance.[36] This approval and determination "shall be final."[37] The contractual indemnification is to apply to and losses not compensated by insurance, including 1) reasonable expenses of litigation and settlement, 2) third party claims, including claims by employees of the contractor, for death, personal injury or property damage or loss; 3) the loss or damage to, or the loss of use of property of the contractor; 4) the loss or damage to, or loss of use of property of the government; and 5) claims arising from indemnification agreements between the contractor and subcontractors, and from indemnification arrangements between subcontractors at any tier, if such arrangements were entered into pursuant to regulations by the secretaries of the department, and of the different armed services.[38] However, indemnification agreements between the U.S. and the contractor or between the contractors and subcontractors may not cover claims or losses caused by willful misconduct or lack of good faith on the part of the contractors' or subcontractors' directors or officers, which are claims by the United States (other than claims arising through subrogation) against the contractor or subcontractor, or losses affecting the property of such contractor or subcontractor.[39]

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[30] Id.

[31] Exec. Order No. 10,789 reprinted in 50 U.S.C.A. §1431 App. at 215 (West Supp. 1987).

[32] 50 U.S.C.A. §1431(I)(1). For discussion of the scope of the law, see Richardson, The Use of the General and Residual Powers under Pub. L. No. 85-804 in the Department of Defense, 14 Pub. Contract L. J. 128 (1983). The author was Attorney/Advisor, Office of Assist. Gen'l. Counsel, DOD.

[33] 50 U.S.C.A. §1431(I)(A)(a).

[34] Id.

It is provided that the United States may discharge its indemnity obligations by making payments directly to subcontractors or to third persons to whom a contractor or subcontractor may be liable.[40] Contractual provisions for indemnification must also provide for notice to the United States of any claim or action which may be covered by such contractual provision, and it must also provide for control or assistance by the United States in the settlement or defense of such claim or action, at the election of the government.[41]

The Executive Order also provides for broad authority relating to contract modification and advance payments, to carry out the purposes of the statute.[42] Pursuant to the Executive Order these broad authorizations apply to the Department of the Treasury, Department of the Interior, Department of Agriculture, Department of Commerce,

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[35] Id.

[36] Id.

[37] Id.

[38] 50 U.S.C.A. §1431(I)(1A)(b)(1).

[39] 50 U.S.C.A. §1431(I)(1A)(b)(2).

[40] 50 U.S.C.A. §1431(I)(1A)(b)(3).

[41] 50 U.S.C.A. §1431(I)(1A)(c).

[42] 50 U.S.C.A. §1431(I)(2).

Department of Transportation, Atomic Energy Commission, General Services Administration, National Aeronautics and Space Administration, Tennessee Valley Authority, Government Printing Office, and the Federal Emergency Management Agency.[43] The head of each of the agencies named is authorized to issue regulations to carry out the functions and authority of the agency, and to the extent practicable, such regulations are to be uniform with the regulations prescribed or approved by the Secretary of Defense.[44]

The purpose of the National Defense Contracts Act, as indicated in the legislative history, was to enact into permanent law "during periods of national emergency and for 6 month thereafter" the authority contained in the first War Powers Act of 1941, which had expired on June 30, 1958.[45] More particularly, the purpose was to empower certain departments or agencies to amend or modify a government contract without additional consideration where necessary to prevent interruption of contract performance.[46] The aim was to make contract adjustment where necessary to advance the defense procurement program.[47] Such adjustments would include contract modifications, advance payment, as well as indemnity provisions "for otherwise noninsurable risks may be provided."[48] The Senate Report notes:

> One of the most significant developments under title II [of the War Powers Act] has been use of that authority as a basis for indemnity provision in certain contracts. Based on the broad language of that act, the authority would be continued under this bill. The need for indemnity claims in most cases is a direct outgrowth of military employment of nuclear power and the highly volatile fuels required in the missile program. Because of the magnitude of the risks involved, commercial insurance policies are either unavailable or provide insufficient coverage. Testimony before a subcommittee of the House Judiciary committee by representatives of the military departments indicated that contractors are therefore reluctant to enter into contracts involving the risk of a catastrophe without an indemnification provision.[49]

The Senate Committee Report also notes that although military departments have specific statutory authority to indemnify contractors engaged in research and development (under 10 U.S.C. §2354)[50] this authority does not extend to production contracts for dangerous products, and, just as in the Price-Anderson Act, to the extent that commercial insurance is unavailable, the risk of loss should be borne by the United States.[51]

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[43] 50 U.S.C.A. §1431(II)21.

[44] 50 U.S.C.A. §4131(II)22.

[45] S. Rep. No. 2281, 85th Cong., 2d Sess. reprinted in 1958 U.S. Code Cong. & Ad. News 4043.

[46] Id.

[47] Id.

[48] Id. at 4049.

[49] Id. at 4045.

It is also to be noted that the extraordinary powers in the National Defense Contracts Act, and particularly the power to indemnify, have never been tested in the courts.

Department of Health and Human Services (HHS) Contracts for Research and Investigation -- 42 U.S.C. §241

Section 241 of Title 42 of the U.S. Code provides broad authorizations for the Secretary to conduct, promote and undertake a variety of researches and investigations to advance various interests in public health. One of his authorizations is to "enter into contracts, including contracts for research in accordance with and subject to the provisions of law applicable to contracts entered into by the military departments and the Sections 2353 and 2354 of Title 10," except that the Secretary of HHS is responsible for approval and certification rather than the heads of the military departments.[52] The inclusion by reference of the powers relating to entering into contracts for research and investigations clearly includes the provisions relating to contractor indemnification.[53] However, HHS does not view this authorization as absolute and tends to treat it as similar to the authorization to indemnify extended under Federal Acquistion Regulations (FAR) 48 CFR 52.228-7, which offers limited indemnification for certain types of contracts. Medicare intermediary and carrier contracts are areas where HHS has provided indemnification clauses pursuant to 42 U.S.C. §1395h(i) and 42 U.S.C. §1395u(e), but again the authority to do so is seen by the Agency as illusory and potentially damaging to appropriations.[54] Aside from the Medicare contracts, there is little evidence that the indemnification authorization has been used by HHS,[55] or that many indemnification claims have been paid.[56]

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[50] See text at N. 24 supra.

[51] Id. at 4045.

[52] 42 U.S.C.A. §241(a)(7) (West 1982).

[53] 10 U.S.C.A. §2354(a).

[54] Letter from Darrel J. Grinstead, Associate General Counsel, HHS, to Marshall J. Breger, Chairman, ACUS, Feb. 25, 1988.

[55] See text at N. 289 infra.

[56] Supra., N. 54.

Indemnification Agreements for Public Contractors Involved in Nuclear Energy Operations

The indemnification for injuries and damages resulting from nuclear accidents arising out of the operation of power plants represents the use of government indemnities in a field which may be considered typical of other areas in which government sponsored modern technology creates a potential for major injuries, and it may also be considered quite unusual and atypical in that its history has its early beginnings as a secret military technology which only later achieved its current position as a recognized source of energy, operated by private industry.[57]

Nuclear technology began as military technology, and when nuclear power was finally applied to peaceful uses beginning in the mid-fifties, nuclear technology was not only a secret technology under exclusive U.S. control, but the government also controlled all nuclear materials which could be used for military proposes or power production. Both the peaceful uses of nuclear energy and federal indemnity for such uses began with the enactment of the 1957 Price-Anderson Act. It was clear from the very beginning -- as the Supreme Court recognized in Duke Power Co. v. Carolina Environmental Study Group, Inc.[58] -- that no utility company would enter the field of nuclear power production unless it had at first been assured of adequate insurance or indemnity coverage to prevent a wipe-out by the liabilities following a nuclear accident.[59] Whether the Price-Anderson Act was primarily designed to protect utility companies against unmanageable liabilities, or to create a sound system of recovery for victims of such an accident, is difficult to tell. During the past 30 years and following several amendments, Price-Anderson has met both purposes, though the atomic energy industry has had greater influence in shaping the provisions of the law than have public interest groups in vindicating the interests of potential accident victims.

The original 1957 Price-Anderson Act established a system of insurance and indemnity for damages caused by "extraordinary nuclear occurrences."[60] Such occurrences include major catastrophic accidents.[61] The determination that such an event has occurred must be made by the Nuclear Regulatory Commission, and its determination is final and unreviewable.[62]

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[57] GRAD, TREATISE ON ENVIRONMENTAL LAW §6.02[3][a].

[58] 438 U.S. 59(1977).

[59] Carolina Environmental Study Group v. Atomic Energy Commission, 431 F. Supp. 203.

[60] Pub. L. No. 85-256, 71 Stat. 576 (1957).

[61] Ibid.

[62] Ibid.

NRC may not grant a license to operate a nuclear power plant unless the operator maintains "financial protections."[63] Similarly requirements are imposed on persons who are NRC contractors or who have licenses for the distribution of special nuclear, special source, or byproduct materials.[64] Financial protection may be in the form of private insurance, private contractual indemnities, self-insurance, or other proof of financial responsibility.[65] For nuclear power reactors the financial protection must equal the maximum amount of liability insurance available from private sources, which, in 1957, was 60 million dollars.[66] In every instance in which the law required financial protection, the NRC also had to enter into an agreement with a licensee to identify the licensee and any other person who may be liable for damages growing out of a nuclear accident in excess of the required financial protection.[67] The indemnity agreement lasts for the life of the license or permit.[68] Under the initial act, the total liability, including the cost of investigating and settling claims and defending damage suits of all persons held liable for an extraordinary nuclear incident, was limited to 500 million dollars plus the amount of the financial protection required. A total limit of 560 million dollars was imposed, however. As originally enacted if the damage from any one nuclear incident appeared likely to exceed this limit on liability, NRC was to seek a court order allowing the funds available to be divided among persons who have suffered or who may suffer, personal injury or whose property has been damaged.[69] The government indemnity was to come into play only if a nuclear incident resulted in liability in excess of the private insurance coverage required by law.

Though the risk of a nuclear accident is extremely low, there were serious doubts whether in the event of such an accident the 500 million indemnity provided under the Act would be sufficient to cover the personal injury and property damage claims which would surely follow.[70] When Price-Anderson was first enacted, there was an expectation that injury and liability claims would be decided under state law and that the states would apply the rule of strict liability to such a hazardous activity.[71] The law did not itself provide that liability regardless of fault was intended, and it was a later amendment that provided that persons injured as a result of major nuclear incidents be compensated for their damages regardless of negligence or fault and the availability of technical legal defenses.[72] In situations other than extraordinary nuclear incidents, the states were free to follow their own law.[73] The provision for federal indemnities was a trade-off for the strict though limited liability provided under the Act.

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[63] Ibid.

[64] Pub. L. No. 85-256 §4, 71 Stat. 576 (1957), discussed in 71 Harv. L. Rev. 750 (1958); Comment, "Atomic Energy -- Indemnity Legislation -- Price-Anderson Amendments to Atomic Energy Act of 1954," 56 Mich. L. Rev. 752 (1958). This section of the Price-Anderson Act amended the Atomic Energy Act of 1954 by adding a new Section 170 to the 1954 Act.

[65] 42 U.S.C.A. §2210(b).

[66] Id.; Hearings Before the Joint Comm. on Atomic Energy on Governmental Indemnity and Reactor Safety, 85th Cong., 1st Sess. 91(1957) (hereinafter cited as 1957 Hearings.)

[67] 42 U.S.C.A. §2210(c). See also 10 C.F.R. 140.20, 140.70.

[68] S. Rep. No. 296, 85th Cong., 1st Sess. at 21.

[69] Section 170. 42 U.S.C.A. §2210(b).

From the very beginning there was a need for government indemnity. The potential dimension of a nuclear accident made it impossible to obtain sufficient liability insurance to cover the entire risk. When the Price-Anderson Act was passed in 1957, the largest liability insurance policy written provided only $25 million coverage.[74] While extent of damages from a nuclear accident was unknown, it was said in legislative hearings that losses could reach hundreds of millions or even billions of dollars.[75] These amounts were beyond the capacity of individual insurance companies, and there was also great uncertainty because there was no actuarial experience on which to measure the degree of risk, because at the time there were also very few members of the utility industry who had participated in nuclear developments.[76] This made the usual rate-setting mechanisms less available, and caused the industry to look for other alternatives.[77]

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[70] Murphy, Financial Protection Against Atomic Hazards, (Legislative Drafting Research Fund, Columbia University 1957). In addressing the question of the extent of damages from a catastrophic event, the author notes at p. 19 "One such estimate, presented by the Commission at the hearings on indemnity legislation in May, 1956, was that property damage in the event of a one hundred percent release of the fission products from an 800 MWH reactor could be between $180 and $900 million. Personal injuries would add materially to these figures."

[71] For influential testimony by Arthur Murphy before the Joint Committee on Atomic Energy, where Professor Murphy expressed confidence that the court of a state where a nuclear incident occurred would ultimately impose strict liability, see Hearings Before the Joint Committee on Atomic Energy on Governmental Indemnity for Prime Licensees and AEC Contractors Against Reactor Hazards, 84th Cong., 2d Sess., at 70-74(1956).

[72] 42 U.S.C.A. §2210(n).

[73] Ibid.

[74] Marrone, "Nuclear Liability Insurance -- A Brief history Reflecting the Success of Nuclear Safety," 12 Nuclear Safety 291 (1971).

[75] See 1957 Hearings of the Joint Committee on Atomic Energy, 85th Cong., 2d Sess. at 11.

At the same time, the insurance industry opposed the idea that government indemnity should be provided in lieu of private insurance, indicating that it would be able through special pooling arrangements to write policies substantially in excess of its prior liability limits.[78] The mix of partial private insurance and partial government indemnity was a compromise between the different contending interests. Public protection required the availability of reliable sources for unprecedented sums which might be needed to compensate victims of a nuclear incident, and industry required some limitation on its liability before entering the nuclear field. The dilemma of choosing an adequate level of protection while maintaining limits on liability acceptable to industry was resolved through the device of government indemnity coupled with an absolute limitation on liability. The Price-Anderson Act gave each of the parties most of what each had sought. It gave the nuclear energy industry a limitation on liability and an insurance requirement which would not be excessively costly; it gave the insurance industry a portion of the business, thereby avoiding a major government entry into the field of insurance; and it gave government a method of avoiding costly administrative programs and a way to provide for some limitations on its liability. It also gave the public an insured source of compensation in the event of an accident, in an amount which was then thought to be adequate to cover any accident except a truly cataclysmic one.[79] Subsequent amendments of the Price-Anderson Act involved the original parties to the compromise, and the 1965 amendment aimed at the coordination of indemnity and insurance agreements, both to prevent gaps in overage and to avoid over-lapping coverage which would result in insurance liability in excess of the aggregate capacity of insurance pools.[80] The further amendment and extension in 1976 increased the total coverage from indemnity and liability insurance, and in addition to a number of technical amendments, adopted provisions that would eventually lead to a phasing out of government indemnities.[81] The impact of the 1977 amendment has been described as follows:

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[76] See McClure, "A Review of Nuclear Energy Insurance," 55 Proceedings of the Casualty Actuarial Society 256 (1968).

[77] See, e.g., Hearings Before the Joint Comm. on Atomic Energy on Governmental Indemnity, 84th Cong., 2d Sess. 110 (1956) (hereinafter cited at 1956 Hearings).

[78] See, e.g., statement of Mr. Herbert W. Young of the American Mutual Alliance in 1956 Hearings at 250. See also Kelly, "Insurance Problems in the Atomic Age," 24.

[79] L. Rockett, Issues of Financial Protection in Nuclear Activities, 2-4 (Legislative Drafting Research Fund of Columbia University, 1973).

[80] *Id*. at 2-5 to 2-9.

> The major change is the adoption of a system of retrospective assessments payable by the licensees of electric power reactors or fuel processing plants in the event of a nuclear incident causing damage above the primary level of financial protection. The amount of this so-called "deferred premium" to be established within NRC rule within a range (prescribed in the statute) of $2 million to $5 million per operating reactor. The objective of this provision is the gradual substitution of private coverage for government indemnity and, in the case of electric power reactors, an eventual raising of the limit of liability substantially above $560 million. It is estimated that, if the predicted growth rate in the number of power reactors is realized, the government indemnity will be phased out in the early 1980's. Thereafter, as the number of reactors increases, the limit on liability will automatically rise -- on the assumed growth rate it is estimated that the limit will reach one billion dollars by 1990. There is no ceiling on the level to which the limit on liability may rise.[82]

As amended in 1977 Price-Anderson provided for a three-tiered recovery system. In the event of a substantial nuclear accident, the available protection from private liability insurance would first be called on to cover damages. Next, under the retrospective rating plan, each major nuclear power plant would be assessed $2 million to $5 million, based on its generating capacity, and if this assessment was not adequate, the balance of up to the statutory maximum of $560 million would come from the public indemnity. Thus, as the number of nuclear power plants increases, the amounts available from retrospective rating assessments would diminish the need for federal indemnity and would, in due course, exceed the limit of coverage then established by statute.

The basic scheme of Price-Anderson, and the provision for limited liability was upheld by the Supreme Court against due process and equal protection challenges in Duke Power v. Carolina Environmental Study

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[81] For discussion of amendment, see Cavers, "Improving Financial Protection of the Public against the Hazards of Nuclear Power," 77 Harv. L. Rev. 644, 648-664 (1964); AEC Study of the Price-Anderson Indemnity Act, in Subcomm. on Legislation of Joint Comm. on Atomic Energy, Selected Materials on Atomic Energy Indemnity Legislation, 89th Cong., 1st Sess. 31-40; see also S. Rep. No. 1605, 89th Cong., 2d Sess. 26 (1966).

[82] A. Murphy, Ed., The Nuclear Power Controversy, ch. 4, "Nuclear Power Plant Regulation," 123-124 (American Assembly 1976). The plan is based on the so-called "NELIA-MAELU Proposal," described in Rockett, L. 77 supra at 5-14 to 5-18.

Group, Inc.[83] Fortunately, there have not been any "extraordinary nuclear occurrences" that would call Price-Anderson into operation. The only case that raised Price-Anderson issues was the Three Mile Island incident which gave rise to litigation involving combined government claims by Pennsylvania and its municipalities for expenses incurred in responding to the Three Mile Island incident.[84]

A new ten-year renewal of the Act became due in 1987. The work in Congress on the Price-Anderson Amendments Act began over two years before its adoption. H.R. 1414 was referred to three House committees which reported the bill with various amendments. The Committee of Interior and Insular Affairs was particularly concerned that the liability of commercial power plants adequately be provided for through the maintenance of the two tier protection system and an increase of deferred premiums required under the second tier. Other areas of concern for the Committee of Interior Affairs included increasing the coverage for the liability of DOE contractors and strengthening congressional commitment to paying full damages for public liability claims exceeding the amount of aggregate liability. The Committee of the Interior also considered the question of indemnification of nuclear pharmacies, but decided to leave alone the existing provisions that give the NRC discretion to monitor the need for indemnification.[85]

All but one of the amendments proposed by the Committee on Science, Space and Technology's dealt with DOE contractors. Specifically, they included requiring DOE to insure its demonstration reactors, ensuring that DOE and NRC do not indemnify the same parties, establishing that DOE may cover legal costs in administering and settling claims and the NRC may only do so for university research reactors, making government indemnification the sole source of funds for payment of liability, and extending the Secretary of Energy's authority to issue Price-Anderson coverage for 12 years to ensure coverage of the public and DOE contractors after the expiration of the 10 year period and before Congress reenacts legislation.[86]

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[83] 438 U.S. 59 (1977). Applying the presumption of constitutionality, the Court held that the $560 million limit on liability was an economic regulation what was not arbitrary or irrational. The Court held that the record supported the need for the limit on liability to encourage private industry to participate in the development of nuclear energy. This encouragement, in the Court's view, bore a rational relationship to congressional concern for stimulating the involvement of private enterprise in the production of electric energy through atomic power. The Court also found that the Act provided a quid pro quo, namely a reasonably substitute for state common law tort remedies by providing the assurance of compensation without proof of fault in return for the $560 million limit on recoveries. 438 U.S. 59, 86-88, 98 S.Ct 2620, 57 L. Ed.2d 595, 8 ELR 20545, reversing Carolina Environmental Study Group v. Atomic Energy Commission, 431 F.Supp. 203, 7 ELR 20315 (W.D.N.C. 1977).

[84] In dismissing the case, the district court indicted that the Price-Anderson Act reflects both a policy to protect the public and the aim to interfere as little as possible with state law. Neither federal or state law makes provisions for recovery of response costs, and absent injury to personal property, there cannot be a recovery for economic loss. In re TMI Litigation Environmental Entities Claim 544 F.Supp. 853, 13 ELR 20122 (M.D. Pa. 1982).

[85] H.R. 1414, Pt. 1 at 20.

The third committee to report on the Price-Anderson Act, the Committee on Energy and Commerce, incorporated amendments regarding compensation for DOE contractors, i.e. providing for the government to pay liability in the case of accidents, other than nuclear waste activities, where the court has determined that public liability is likely to exceed the liability limit.[87] The Committee provided that a court may not approve the payment of legal costs unless such payments will not jeopardize compensation of victims, and addressed the questions of consolidation of claims and the obligation of DOE waste transporters to have a certain amount of commercial insurance.[88]

After passing the House on July 30, 1987, H.R. 1414 was adopted with some amendments in April 1988 by the Senate. Areas of significant difference between the House and Senate versions included provisions for nuclear pharmacies, the liability of DOE employees, and the extension of NRC and DOE to enter into indemnity agreements. Due to these differences, a compromise bill was developed which resolved the conflict between the Senate and the House on the number of years the NRC and DOE can make indemnity agreements, but otherwise substantially preserved the House committees' amendments. On August 5, 1988, the Senate agreed to adopt H.R. 1414 which reauthorized the authority of the original Price-Anderson Act with some changes, ending the considerable controversy between the interest groups that had been involved in shaping the law since its beginning.[89] On August 20, 1988, the President signed H.R. 1414 into law.

The Price-Anderson Amendments Act of 1988, as H.R. 1414 is now called, raises the total funds available for victim compensation from $700 million under the earlier law to $7.4 billion or more.[90] As in earlier versions of the law, though the amount available for compensation was increased more than tenfold, it would still come from a combination of private insurance and "deferred premiums" payable by utility companies for each of their nuclear reactors following an accident at any one reactor in the nation. Similar to earlier law, the new Act does not make any provisions in the event that the $7.4 billion are insufficient to meet the liabilities. The new Act would require the President to submit a plan to Congress to provide for the payment of damages, but it does not provide for spending beyond the authorizations.[91]

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[86] H.R. Rep., 100-104, 100th Cong., 1st Sess., pt.2 (1987).

[87] Id., pt.3 at 17

[88] Id. at 19.

[89] Congressional Quarterly, Aug. 1, 1987, p. 1731.

[90] Price-Anderson Amendments Act of 1988, 100th Cong., 2d Sess. (1988).

The new Act retains the provision of the past law under which the government pays for the damages, up to a certain limit, in any accident caused by a Department of Energy contractor.[92] Environmental, consumer, and taxpayer groups supported amendments to increase the nuclear industry's financial responsibility in the event of a major accident, but the Act as finally adopted retained the limit on industry liability, and did not provide for increases in the deferred premium payments. Efforts to amend the proposal to compel contractors to pick up a greater amount of damages were rejected. Proponents of the amendment had asserted that over the past years the government had spent $124 billion dollars on such contracts while damage claims paid by the government added up to one and a half million, showing that the nuclear industry could well afford to pay a larger portion of damages.[93]

As signed by the President, the Act provides that damages for nuclear accidents would first be paid out of the $160 million available private insurance and the maximum deferred premiums collected from all operating reactors. Based on the existing 109 reactors, deferred premiums would start at $7.027 billion, and damages beyond the sum of insurance and deferred premiums would constitute the limit on compensation in the absence of further congressional legislation. The law also provides for the adjustment of deferred premiums in the event more than one extraordinary nuclear incident happens in any one year, and authorizes federal borrowing to be repaid from deferred premiums, when in any one year damage claims exceed the amount collected in such deferred premiums. Most importantly, the law extended for an additional 15 years, until August 1, 2002, the authority of NRC to enter into indemnification agreements with operators of electric generating reactors, whether commercial or research in purpose. The new Act expressly requires DOE to indemnify its contractors.[94] Under earlier law, DOE had discretion on the issue.

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[91] Id., at § 6, amendment to § 170e of the atomic Energy Act.

[92] Id., at § 4, amendment to §170d of the Atomic Energy Act.

[93] Industry relied on the initial bargain in the passage of Price-Anderson that provided limits on industry liability in return for a no-fault compensation system. The industry and industry supporters also prevailed with respect to the payment of legal costs in the event that damages from an accident exceeded the $7.4 billion coverage. Legal costs include both the costs of the utility industry as well as legal costs of victims, and the fund was not protected from the payment of legal costs in spite of the assertion that such costs may contribute to the depletion of the fund. Congressional Quarterly, Aug. 1, 1987, pp. 1731, 1733.

Damages from a nuclear accident involving an indemnified DOE contractor would be paid from the general fund, to the approximate amount of commercial liability, i.e. $7 billion. Damages from nuclear waste accidents involving DOE contractors are to be paid from the Nuclear Waste Fund, established under the 1982 Nuclear Waste Policy Act, again up to the $7 billion mark.[95] Damages beyond that amount would be paid from the General Treasury if Congress did not act within one year of receiving a compensation plan from the President. The law sets $100 million as the limit on compensation on federally covered nuclear waste accidents. In a provision which reflects the Three Mile Island experience, the Act provides that the cost of precautionary evacuations would be covered, if legally responsible state or local officials determine that such an evacuation is necessary and constitutes a public liability.[96]

The Act creates new procedures relating to compensation for damages. When damages are likely to go over the limit established by law, the NRC or DOE must survey the causes and extent of damage and report their findings to Congress, the public, and the nuclear industry, as well as to the courts. If a court finds that the damages may exceed the limit, the President would be required to submit a plan to Congress within 90 days, including an estimate of the total damage expected, and recommendations on the source of funds to pay for damages above the limit. The President's report to Congress would contain one or more plans to provide for prompt and full compensation and could recommend any additional legislative changes needed to implement such plans.[97]

Section 9 of the amended law requires the presidential appointment of a commission to study means of fully compensating victims of a catastrophic nuclear accident that exceeds the amount of aggregate liability and to recommend changes in the laws and rules governing liability.[98] Section 10 eliminates the 20-year statute of limitations on suits by an accident victim and henceforth a claim is valid as long as it is brought within three years from discovery of the injury.[99] The Price-Anderson Amendments Act in Section 11 provides for the consolidation of claims arising from "a nuclear incident" thus removing the "extraordinary nuclear occurrence" test of the previous law.[100] This provision allows consolidation of claims to apply retroactively. Under Section 11, a court with jurisdiction may appoint a special case load management panel to consolidate and assign cases arising out of a nuclear incident.

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[94] Id., at § 4.

[95] Id., at § 4, amendment to §170(d)(1)(B)(ii) of the Atomic Energy Act.

[96] Id., at § 5, amendment to §11w of the Atomic Energy Act.

[97] Id., at § 7, amendment to §170i of the Atomic Energy Act.

[98] Id., at § 9, amending 42 U.S.C.A. § 2210.

[99] Id., at § 10, amending 42 U.S.C.A. § 2210(n)(1).

Legal costs may be paid from the amount of financial protection, but only upon the court's authorization. Claimants must demonstrate that they litigated in good faith, avoided unnecessary duplication of effort, did not make frivolous claims, and did not attempt to delay the prompt settlement or adjudication of claims.[101] Furthermore, if public liability claims and legal costs exceed the maximum amount of financial protection, any licensee required to pay a deferred premium shall also be charged such an amount as is necessary to pay a pro rata share of such claims and costs, but not to exceed five percent of the deferred premiums.[102] Section 14 provides that no court may award punitive damages in any action with respect to a nuclear incident or precautionary evacuations against a person on behalf of whom the United States government is obligated to pay. With regard to NRC licenses, the law established under the Atomic Energy Act still does not prohibit a court from awarding punitive damages under state law.[103]

The Price-Anderson Amendments Act also provides for new civil and criminal penalties. Section 17 establishes civil liability for all DOE contractors who violate any rules, regulations, or orders issued by the Secretary of Energy. The Secretary may assess the penalties after the violator has been given notice of the opportunity to elect in writing the mode of assessment. Criminal penalties, under Section 18, provide that persons indemnified by DOE under Section 170(d) of the Atomic Energy Act, who knowingly and willfully violate applicable nuclear safety-related rules, regulations, or orders issued by the Secretary of Energy shall be subject to a fine of not more than $25,000, imprisonment of not more than two years or both. For a second conviction, the fine will be $50,000, imprisonment for not more than five years, or both.

The Act requires DOE and NRC to report annually to Congress by April 1 on their activities under the Act, and it also requires DOE to report to Congress by February 1, 1988 on the criminal and civil labilities of DOE contractors and other indemnified persons who intentionally cause or try to cause an accident at a DOE facility.[104]

It is difficult to separate the indemnity provisions of the Price-Anderson Act from the rest of the compensation scheme and from other aspects of the relationship of insurance and indemnity in the operation of the nuclear power industry. It is also clear that the nuclear power industry, assured of federal indemnities since 1957, will not readily surrender that advantage, even though it is no longer the infant industry it was in 1957. While the reliance on retroactive premium payments for nuclear power licensees may well displace federal indemnities for licensees, in the case of DOE contractors, i.e. in the case of nuclear plant operators under contract with the government, indemnities are not only well-established but were raised tenfold in 1988 over their prior level.

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[100] Id., at § 11, see 42 U.S.C.A. § 2210(n)(2).

[101] Id., at § 11.

[102] Id., at § 11(d)(2), amending 42 U.S.C.A. § 2210(o).

[103] Id., at § 14.

[104] Id., at § amendment to §170p of the Atomic Energy Act.

Contract Settlement Act of 1944

A broad indemnification provision appears in the "Contract Settlement Act of 1944" enacted on July 1, 1944 "to facilitate maximum war production during the war, and to expedite reconversion from war production to civilian production as war conditions permit"; and further "to assure prime contractors and subcontractors, small and large, speedy and equitable final settlement of claims under terminated war contracts, and adequate financing until such final settlement[.]"[105] The Contract Settlement Act of 1944, in a section entitled "Broad Powers and Duties of Contracting Agencies" provides that such contracting agencies may make contracts necessary and appropriate to carry out the provisions of the chapter, to amend by agreement any existing contract either before or after notice of its termination, on such terms and to such extent as it deems necessary to carry out the provisions, and "in settling any termination claim, to agree to assume, or indemnify the war contractor against any claims by any person in connection with such termination claims or settlement."[106] There is no evidence that this broad grant of powers to indemnify has ever been litigated.

Federal Aviation Act of 1958, As Amended

Another war risk related indemnity provision is provided for under the Federal Aviation Act of 1958 as amended in 1977. (49 U.S.C.A. §1531 *et seq.*) The law originally provided authority for the insurance or reinsurance of any civil American aircraft, against "war risks". The term war risks includes, "to such extent as the Secretary may determine, all or any part of those risks which are described in "Free of Capture and Seizure" clauses, or analogous clauses."[107] As amended in 1977, the authorization changed from that of a long-term was risk insurance business to a more limited, short-term business of insuring for short periods against "any risk from the operation of an air craft, when the President finds that insured operation is necessary to carry out the foreign policy of the U.S."[108]

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[105] 41 U.S.C.A. §101. See 1944 U.S. Code Service, 1161.

[106] 41 U.S.C.A. §120(a)(3).

[107] 49 U.S.C.A. §1531 (West Supp. 1987).

[108] *Id.*, Pub. L. 95-163. See 1977 U.S. Code Cong. & Ad. News 3383.

Under the original law, the Secretary of Transportation was authorized to provide insurance and reinsurance against loss or damage arising out of war risks with the approval of the President and after consultation with the interested agencies of the government, whenever the Secretary determined that the insurance adequate for the needs of air commerce of the United States cannot be obtained on reasonable terms from companies authorized to do insurance business in any state of the United States. Insurance or reinsurance issued under the act was to be based as far as practicable on consideration of the risks involved.[109]

The coverage of the insurance and reinsurance anticipated was to include American aircraft or foreign flag aircraft whose operation was deemed to be by the Secretary in the interest of national defense or the national economy of the United States.[110] Also covered is air cargo transported on any such aircraft, including shipments by express or registered mail, air cargo imported to or exported from the United States, air cargoes sold or purchased by citizens or residents of the U.S. under contracts of sale or purchase by the terms of which war risks or the obligation to provide insurance against war risks is assumed by or falls upon citizens or residents of the U.S., including air cargo transported between the U.S. and any point in a territory or possession of the U.S.[111] Included also are personal effects and baggage of the crew of such aircraft and of persons employed or transported on such aircraft.[112] The crews of such aircraft and persons employed or transported on such aircraft are also to be insurable against loss of life, injury or detention.[113] The insurable interest also includes statutory or contractual obligations or other liabilities of such aircraft or the owner or operator of such aircraft, as customarily covered by insurance.[114]

Other departments or agencies of the United States, with the approval of the President, could procure from the Secretary of Transportation insurance provided under the Act, and with such approval the Secretary could provide such insurance at the request of the Secretary of Defense and other agencies as prescribed by the President, without premium, in consideration of the agreement by the Secretary of Defense or such agency to indemnify the Secretary of Transportation against all losses covered by such insurance.[115]

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[109] 49 U.S.C.A. §1532 (1976).

[110] 49 U.S.C.A. §1533(a)(1976).

[111] 49 U.S.C.A. §1533(b)(1976).

[112] 49 U.S.C.A. §1533(c)(1976).

[113] 49 U.S.C.A. §1533(d)(1976).

[114] 49 U.S.C.A. §1533(e)(1976).

[115] 49 U.S.C.A. §1534(a)(1976).

In every instance where the Secretary may provide insurance, he may also provide reinsurance for any insurance company authorized to do business in any state of the United States and he may reinsure with, cede, or retrocede to any such company any insurance or reinsurance provided by him in accordance with the Act, at rates comparable to private insurance rates.[116]

The law authorizes the creation of a revolving insurance fund, consisting of monies appropriated to the fund to carry out the purposes of the law, as well as all monies received from premiums, salvage and other recoveries.[117] Such a fund is to be used to pay return premiums, losses, settlements, judgments in all liabilities incurred by the United States under this Act.[118] Surplus funds are to be paid over to the Treasury and sums in the revolving fund may be invested in interest-bearing securities of the United States.[119] The law set forth detailed administrative provisions, which in effect authorize the Secretary of Transportation to run an insurance business.[120] The Act required annual and quarterly reports to Congress, but was amended in 1965 to do away with the requirement of quarterly reports.[121] The Act also provided that the district courts would have jurisdiction over any claim or dispute under the act, and provided also for the joinder of all interested parties in an action before the district courts.[122] To accomplish the purpose of having the district courts dispose of claims under the Act, the Act allows actions to be brought against the United States, thereby waiving sovereign immunity.[123]

Although liabilities relating to the originally authorized war risk insurance may still continue, the authority of the Secretary of Transportation to run this insurance business was initially scheduled to expire on May 7, 1976, but was extended in 1976, 1977, 1982, and 1987. The 1987 amendment extended the Act to Sept. 30, 1992 but as noted earlier, the nature of the insurance business authorized has changed.[124] Instead of "war risks," the Secretary may provide "insurance and reinsurance against loss or damage arising out of any risk from the operation of an aircraft ... wherever it is determined by the Secretary that such insurance cannot be obtained on reasonable terms and conditions from any company authorized to do an insurance business in a State of the United States."[125] Such insurance may be provided only for an initial 60-day period renewable for sixty-day terms upon a new Presidential determination for each period of extension.[126]

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[116] 49 U.S.C.A. §1535(1976).

[117] 49 U.S.C.A. §1536(1976).

[118] Id.

[119] 49 U.S.C.A. §1536(c),(d)(1976).

[120] 49 U.S.C.A. §1537(1976).

[121] Pub. L. 89-348 §1(6), Nov. 8, 1965, 79 Stat. 1310.

[122] 49 U.S.C.A. §1540(1976).

[123] Id.

[124] Pub. L. 97-309, 96 Stat. 1453.

The legislative history of the 1977 amendment indicates that the purpose of this bill was to expand the types of risks which the Secretary of Transportation may insure or reinsure.[127] During times of stability in the aviation insurance market "war risk" policies are available on reasonable terms, but during international crisis most of these policies terminate or become unobtainable.[128]

In 1975, it was brought to Congress' attention that commercial underwriters were drafting exclusions in their "war risk" policies following certain hijacking incidents, the Saigon evacuation and other riots and civil disorders.[129] This created a potential gap in air carriers' insurance coverage. House Document 94-414 recommended that the Secretary of Transportation provide interim insurance -- in addition to that for war risks -- when not available elsewhere and when required by reasons of foreign policy for the continuation of a particular air service.[130] The House Report notes that the law contains safeguards to insure that the government does not end up providing insurance on a routine basis. Thus, the following features are provided for:

1) this is a discretionary program -- no air carrier has a right to insurance or a policy;
2) the Secretary of Transportation, before issuing a policy, must consult with such agencies as the President directs;
3) the President must approve the issuance of each policy; and
4) policies cannot be issued for periods exceeding 60 days.[131]

The 1987 amendment of the law renewed the authorization for the program until September 30, 1992.[132] In extending the program, it kept the established test: 1) the Secretary of Transportation must find that insurance cannot be acquired from domestic commercial insurance companies on reasonable terms and conditions and 2) the President must determine the Nation's foreign policy or national security objectives would be threatened if air service to certain foreign destinations could not be continued because of the unavailablity of commercial insurance.[133] The 1987 amendment also continued to recognize the two types of insurance programs seen in the 1982 version: premium and non-premium.[134] Premium insurance is issued by the FAA and the airline pays a premium for coverage, and non-premium insurance is issued to airlines operating under a government contract (such as the Department of Defense's Military Airlift Command contracts).[135] In the latter case, there is no premium and the contracting government department agrees to indemnify the Department of Transportation for any claims which are paid.[136]

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[125] 49 U.S.C.A. §1532(a)(West Supp. 1987).

[126] 49 U.S.C.A. §1532(c)(West Supp. 1987).

[127] P.L. 95-163. See 1977 U.S. Code Cong. & Ad. News 3383.

[128] H. Rept. No. 95-301, Public Works and Transportation Committee, to accompany H.R. 6010, May 12, 1977.

[129] *Id*. at 2.

[130] *Id*. at 2.

[131] *Id*. at 2.

[132] Pub. L. No. 100-148 (1987), 101 Stat. 878.

There are currently no claims pending and there has not been a claim since 1975.[137] Indeed, the program has not needed to issue insurance since the end of the Vietnam War, nor has it required appropriations in recent years.[138] As of June 1, 1987, the fund had a balance of $37.7 million derived from premiums issued and interest earned on the funds.[139] Continued renewal of the program is evidenced by its eight-time reauthorization.[140] The program is considered a backup for U.S. foreign policy. Although it has not been used recently, there is always a possibility that private insurance companies may be unwilling to insure air service to a foreign country in which there are security problems. While subchapter 13 on Aviation Insurance is not couched in terms of indemnification, it is a governmental indemnity in its operation and in its intent, to advance the interest of the U.S. in certain aspects of foreign relations.

Indemnification under National Aeronautics and Space Act of 1958

NASA obtained special authorization to indemnify users of its space craft in a 1979 amendment of the National Aeronautics and Space Act of 1958.[141] The amendment authorized NASA "on such terms and to the extent it may deem appropriate to provide liability insurance for any user of a space vehicle to compensate all or a portion of claims by third parties for death, bodily injury, or loss of or damage to property resulting from activities carried on in connection with the launch, operations or recovery of the space vehicle."[142] The Administration may acquire such liability insurance from available appropriations, but to the maximum extent practicable, the users of space craft are to reimburse the Administration in accordance with established reimbursement policies.[143] Furthermore, in accordance with administrative regulations, which are to take into account the availability, cost and terms of liability insurance, the Administrator may in any agreement with the user of a space vehicle provide that the U.S. will indemnify the user against claims, including litigation and settlement costs, by third parties for bodily injury or loss of or damage to property resulting from activities carried on in connection with the launch, operation or recovery of the space vehicle.[144] Indemnity may be provided and to the extent that claims are not compensated by liability insurance and indemnities may be limited so as not to cover claims resulting from the actual negligence or wilful misconduct of the user.[145] Indemnity agreements must also provide for notice to the United States of any claim or suit for covered risks, and they must also provide for the "control of or assistance in defense by the United States, at its election, of that suit or claim."[146] Payments of claims for indemnity require a certification by the Administrator that the amount is just and reasonable.[147] Such payments must be made from funds not otherwise obligated for research and development, or from funds appropriated for such payments.[148]

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[133] S.R. Rep. No. 100-147, 100th Cong., 1st Sess. 3 at 2 (1987).

[134] Id.

[135] Id.

[136] Id.

[137] Id. at 3.

[138] Id. at 4.

[139] Id. at 3.

[140] Id. at 2.

[141] Pub. L. No. 96-48, (Oct. 1, 1979), 42 U.S.C. §2458b.

The Senate Commerce, Science and Transportation Committee described the liability and indemnity provision of the amendment as follows:

> The new section 308 includes six subsections, (a) through (f).
>
> Subsection (a) authorizes the Administrator to provide liability insurance to any user of a space vehicle to compensate them for claims by third parties for damage resulting from described activities. The Administration is authorized to provide such insurance in its sole discretion on such terms and to the

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[142] 42 U.S.C. §2458b(a)(West Supp. 1987).

[143] Id.

[144] Id., §2458b(b).

[145] Id., §2458b.

[146] Id., §2458b(c)(1).

[147] Id., §2458b(d).

[148] Id., §2458b(e).

extent it may deem appropriate.[149] Thus, for example, the Administration could require certain Shuttle users to obtain through NASA and pay for an equitable share of third-party liability insurance. On the other hand, the administration could, in its discretion, exempt other Shuttle users, for example, small self-contained payloads, from the requirement of obtaining insurance or paying for it.

This subsection authorizes the Administrator, for example, to procure insurance for a number of Shuttle flights in the future based on a projected schedule. In doing so, he is authorized to use for the purchase of such insurance appropriated funds available to the Administration. In turn, he is required to seek reimbursement of the appropriation used, to the maximum extent practicable, from the users under general Shuttle reimbursement policies established pursuant to section 203(c) of the National Aeronautics and Space Act of 1958, as amended. This could be accomplished by charging users a fixed price for the insurance based upon an estimate of the cost of insurance, the number of other relevant factors. Any other reasonable method of charging users for such insurance may be adopted, depending on NASA's experience and the insurance coverage available. It is not anticipated that NASA would use its appropriated funds to protect the U.S. Government (including NASA when flying its payloads) from liability; however, the subsection is broad enough to permit that if the Administrator determines that to do so would be desirable and appropriate in any particular case, for example, depending on the mix of payloads to be flown on a given Shuttle flight.[150]

Subsection (b) authorizes NASA, in its discretion, to provide in any agreement entered into by it and a user of a space vehicle (as defined in subsection 308(f)), for the indemnification of the user against claims by third parties (as defined in subsection 308(f)) for damage resulting from activities carried on in connection with the launch, operations, or recovery of the space vehicle, but only to the extent that such claims are not compensated by liability insurance of the user. It requires the Administrator to issue implementing regulations which take into account the availability, cost, and terms of liability insurance.[151]

The agreement to indemnify may be inserted in several different types of agreements with users of a space vehicle, including but not limited to, agreements under which NASA provides Shuttle launch services and other Government services and agreements under which non-U.S. Government persons provide to NASA payload specialist services on board Shuttle flights.

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[149] S. REP. NO. 96-207.

[150] Id. at page 46.

[151] Id.

It is specifically provided that the indemnification may, if the administration deems it appropriate, be limited to claims other than those resulting either from the actual negligence of the user or from willful misconduct of the user, or both.[152] Under this authority, the Administrator will be able to tailor the extent of the indemnification to the particular circumstances of a given flight, indemnifying the user totally or, for example, indemnifying the user only with respect to damage or injury which did not result from the user's willful misconduct.

Indemnification is only applicable to claims of third parties who are defined in subsection 308(a)(f)9#) as "any person who may institute a claim against a user for death, bodily injury or loss of or damage to property." It is envisaged that a third party would not normally include persons who contract with NASA for launch services, since NASA expects to include in its launch agreements a provision under which the person procuring launch services agrees that he will not make a claim (and that he will hold NASA and other users harmless) for damage to his property or employees. The result would be that each person flying on a space vehicle would be required either to insure or self-insure his own property.

The indemnification authority is applicable to damage resulting from activities carried on in connection with the launch, operations, or recovery of a space vehicle. The term "space vehicle" is defined in subsection 308(f)(1) to include spacecraft and other payloads that may be launched, with the term specifically including the Space Shuttle. The Administrator's implementing regulations would define technically and in detail the activities carried on that would be protected by indemnification and the extent and duration of such protection.

Subsection (c) provides that certain described conditions must be contained in any agrement providing for indemnification under section 308. Specifically, it requires that (1) notice be given to the (2) control of or assistance in the defense by the United States, as its election, of that suit or claim.

Subsection (d) provides that no indemnification payment made under subsection (b) may be made unless the Administrator or his designee certifies that the amount is just and reasonable.

Subsection (e) provides that upon the Administrator's approval, indemnification payments under subsection (b) may be made either from any funds available for NASA's research and development activities not otherwise obligated or from funds appropriated specifically for such indemnification payments. A decision on whether to use existing appropriations or seek additional appropriations from Congress specifically to pay meritorious claims rests with the Administrator. It is the intent of the subsection that no authorized NASA program should be curtailed or terminated because of such indemnification payments.

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[152] Id.

Assumption of Liabilities Under the Expired Swine Flu Immunization Project

In 1976, Congress authorized the Public Health Service to make grants to the states for a swine flu immunization program as part of the general program of federal project grants for preventive health services.[153] The swine flu immunization program -- to counter the threat of an epidemic that never happened -- was to continue until August 1, 1977. It was to consist of the development of a safe and effective swine flu vaccine, and the preparation and procurement of such a vaccine in sufficient quantities for the immunization of the population of the states.[154] The grants under the program were to assist state health authorities to meet the costs of conducting programs to administer vaccine and help in the furnishing to state health authorities of sufficient quantities of swine flu vaccine for the program.[155] Appropriate quantities of swine flu vaccine were also to be furnished to federal health authorities.[156] Funds were also to be used for training purposes in the administration of the vaccine and in the related research activities.[157]

The program was also to include the development, in consultation with the National Commission for the Protection of Human Subjects of Biomedical and Behavioral Research, of procedures to assure that risks and benefits of the swine flu vaccine are fully explained to individuals to whom the vaccine is to be administered.[158]

An unusual provision of the law required contracts for procurement by the U.S. of swine flu vaccine to be subject to renegotiation to limit profits to reasonable profit realized from the procurement of the vaccine. The criteria to determine reasonable profit were to specify "that any insurance premium amount which is included in the price of such procurement contract and which is refunded to the manufacturer under any retrospective, experience-rating plan or similar rating plan shall in turn be refunded to the United States."[159]

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[153] Pub. L. No. 94-380, 42 U.S.C. §247b(j to l) (prior to revision by Pub. L. No. 95-626 (July 10, 1979).

[154] 42 U.S.C.A. §247b(A) and (B).

[155] 42 U.S.C.A. §247b(c).

[156] 42 U.S.C.A. §247(b)(D)

[157] 42 U.S.C.A. §247(b)(E).

[158] 42 U.S.C.A. §247b(E).

As part of the law Congress made a number of findings which indicate congressional awareness of the risks of the program and of the need for government indemnification. To secure the participation in the program of agencies, organizations and individuals who manufacture, distribute and administer the swine flu vaccine, Congress found it necessary to protect the participants in the program against liability, for other than their own negligence, to persons alleging personal injury or death arising out of the administration of the vaccine.[160] To provide such protection and to establish an orderly procedure for the handling of such claims, Congress found that an exclusive remedy against the United States had to be provided for such claimants.[161] Moreover, in order to be prepared to meet the potential emergency of a swine flu epidemic, procedures for the handling of claims must be provided "until Congress develops a permanent approach for handling claims arising under the programs of the Public Health Service Act."[162]

To accomplish the purposes of the Act, claims under the Act were to be brought directly against the United States under the Federal Tort Claims Act.[163] The liability of program participants was to be based on a theory of liability that would govern an action under the law of the place where the act or omission occurred, whatever the theory, "including negligence, strict liability in tort, and breach of warranty."[164] The Act also eased a number of procedural requirements in order to avoid problems arising from the tolling of statutes of limitation and other time limits.[165] The law also provided for the defense of government employees in civil actions by the Attorney General and for the removal of such actions from the state courts to the federal district court.[166] When the U.S. makes payment on a claim, either after judgement or after settlement, the U.S. is granted a right of subrogation against a participant in the program growing out of the failure to carry out obligations and responsibilities assumed by it under a contract with the United States, or out of any negligent conduct in carrying out its obligations or responsibilities under the program.[167]

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[159] 42 U.S.C.A. §247(b)D(3).

[160] 42 U.S.C.A. §247(b)(k)(1)(A)(i).

[161] 42 U.S.C.A. §247(b)(k)(1)(A)(ii).

[162] Id. 42 U.S.C.A. §247(b)(k)(1)(A)(iii).

[163] Id. 42 U.S.C.A. §247b(k)(1)B(ii).

[164] 42 U.S.C.A. §247(b)k(2)(A)(1).

[165] 42 U.S.C.A. §247(b)k2(A)(iii).

[166] 42 U.S.C.A. §247(b)k(4), §247(b)(k)(5)(A).

The Swine Flu Program is an instance in which the United State assumed full liabilities as a defendant, instead of acting as an indemnitor. The case of the swine flu program is frequently cited to prove that the establishment of indemnities creates a deep pocket and that a deep pocket stimulate claims that would not have been brought but for the deep pocket.

The many cases brought and decided under the swine flu legislation reflect the recurring pattern of decisions in cases of contractor indemnities, where the basis of the liability is a federal law, such as the Tort Claims Act, or a federal contract, but where the theory of law applicable to the case is based on state law under applicable rules relating to choice of law.[168]

Authorization of Indemnities for Certain Contracts of the Veterans' Administration Department of Medicine and Surgery

The Department of Medicine and Surgery in the Veterans' Administration, under the Chief Medical Director, has a wide array of functions and powers relating medical research, prosthetic research and medical manpower training, and it may enter into contracts to carry out these functions. With the approval of the Administrator, "any contract or research" authorized by this section, the performance of which "involves a risk of an unusually hazardous nature" may provide for indemnification."[169] However, only liabilities arising out of the direct performance of the contract are indemnifiable, and only to the extent that such risks are not covered under state or federal workers' injury compensation laws.[170] Indemnification is granted for death, bodily injury or loss or damage to property from a risk that the contract defines as unusually hazardous.[171] As is common in other indemnification authorizations, the contract that provides for indemnification must provide for notice to the United States of any claim or suit, and must also provide for control of or assistance in the defense by United States if it so elects.[172] Payment of the indemnification may be made only if the administrator certifies that the amount is just and reasonable.[173] Payment may be made from funds obligated for the performance of the contract concerned, funds payable for research or development or both not otherwise obligated; or funds appropriated for those payments.[174]

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[167] 42 U.S.C.A. §247(b)(k)(7).

[168] Hunt v. U.S., 636 F.2d 580, (D.C. Cir. 1980); Daniels v. U.S., 704 F.2d 587 (11th Cir. 1983).

[169] 38 U.S.C. §4101(c)(3), added by Pub. L. No. 94-581, effective October 21, 1976.

[170] 38 U.S.C.A. §4101(3)(A).

[171] 38 U.S.C.A. §41013(A)(1).

[172] Id. §4101(3)(B)(ii).

[173] 38 U.S.C.A. §4101(3)(c).

A contractor which is a party to an indemnification agreement must maintain financial protection to cover third party liability in the maximum amount of private insurance available from private sources. The Administrator may establish a lesser amount of financial protection, taking into consideration the costs and terms of private insurance.[175] In administering the indemnification provisions, the Administrator may use the facilities and services of private insurers.[176] The authority to indemnify contractors does not provide any rights to third persons which do not otherwise exist by law.[177]

International Communication Agency

The International Communication Agency, in making contracts for the use of international short-wave radio stations and facilities, has the authority to agree on behalf of the United States to indemnify the owners and operators of such stations against loss or damage on account of injury to persons or property arising from the use of such stations.[178] The authority is to indemnify from such funds as may be hereafter appropriated for the purpose. This authority was most recently provided as part of the Department of State, Justice, and Commerce, the Judiciary, and Related Agencies Appropriations Act of 1979. Similar authorizations were contained in prior appropriations acts starting in 1954.

Federal Council on the Arts and Humanities Indemnities for Loss or Damage of Artworks and other Objects

Another indemnity provision of a more unusual character is contained in the legislation for the creation and activities of the Federal Council on the Arts and Humanities. The Federal Council on the Arts and Humanities was granted authority to make agreements to indemnify against loss or damage of works of art, including tapestries, paintings, sculpture, folk art, graphics, and craft arts, as well as manuscripts, rare documents, books, and other printed or published materials, and other artifacts or objects.[179] The coverage of indemnity also extends to photographs, motion picture, or audio and video tapes. The objects to which indemnity extends must be of educational, cultural, historical, or scientific value, and their exhibition must be certified by the Director of the U.S. Information Agencies as being in the national interest. Indemnity agreements made pursuant to his provision are to cover eligible items while on exhibition on the United States or elsewhere, "preferably when part of an exchange of exhibitions."[180]

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[174] 38 U.S.C.A. §4101(3)D(1),(ii),(iii).

[175] 38 U.S.C.A. §4101(3)(E).

[176] 38 U.S.C.A. §4101(3)(F).

[177] 38 U.S.C.A. §4101(3)(G).

[178] 22 U.S.C.A. §1461(b).

[179] Pub. L. No. 94-158, eff. Dec. 20, 1975, 20 U.S.C. §971.

The law provides for the manner in which application for indemnity agreements may be made by any person, non-profit agency, institution, or government. Upon approval of an application for indemnity by the Council, the indemnity agreement "shall constitute a contract between the Council and the applicant pledging the full faith and credit of the United States to pay any amount for which the Council becomes liable under such an agreement."[181]

The law provides for deductible limits of indemnity. For instance, when the estimated value of the covered item is more than 2 million dollars but less that 10 million dollars, then coverage under the law shall extend only to loss or damage in excess of the first $25,000 of loss covered.[182]

Prompt adjustment of claims is provided for, and in case of a claim of loss on a covered item, the Council shall certify the validity of the claim and the amount of the loss to the Speaker of the House of Representatives and the President Pro Tem. of the Senate.[183] Annual reports to Congress of claims actually paid and claims pending during the past fiscal year must be provided (20 U.S.C. §971-977).

Environmental Protection Agency: Authorization of Indemnification Under Superfund Law

Section 119 of the Superfund Law, the Comprehensive Environmental Response Compensation and Liability Act (CERCLA), as added by the Superfund Amendments and Reauthorization Act of 1986, provides authority for contractual indemnification of "response action contractors."[184] A response action contractor (RAC), namely a person hired or retained to provide services in response to any release or threatened release of a hazardous substance, or pollutant or contaminant from a facility regulated under the Superfund law,

> shall not be liable ... to any person for injuries, costs, damages, expenses, or other liability (including but not limited to claims for indemnification, or contribution and claims by third parties for death, personal injury, illness of loss of or damage to property or economic loss) which results from such release, or

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[180] 20 U.S.C.A. §972(b).

[181] 20 U.S.C.A. §973.

[182] 20 U.S.C.A. §974.

[183] 20 U.S.C.A. §975.

[184] CERCLA §119 as amended by SARA §119, 42 U.S.C.A. §9619.

threatened release.[185]

However, the immunity does not apply to releases caused by the RAC's negligent or grossly negligent conduct, or by the RAC's intentional misconduct.[186] The indemnity is not to affect liabilities under existing state, local or common law warranties, nor is it to affect the liability of any RAC to its employee under other provisions of law, including workers' compensation law. The section expressly includes state and local government employees who perform such duties within the indemnification protection granted to RACs.[187]

The section expressly provides that the indemnification is not available to any potentially responsible party (PRP) with respect to the costs or damages caused by any act or omission of a RAC. Furthermore, the section does not affect to plaintiff's burden of proof in establishing liability for releases under the act.

If an RAC meets the requirements of the law, the President may agree to hold the RAC harmless and indemnify it against any liability (including expenses of litigation and settlement) for negligence arising out of the RAC's performance in carrying out response action activities, unless the liability was caused by the RAC's grossly negligent conduct, or by its intentional misconduct.

The amendment provides that the law is not to be subject to 31 U.S.C. §§1301 and 1341, or to the limitations on obligations to amounts appropriated as provided in 42 U.S.C.A. §9662. Uses of funds, for the indemnification of any RAC (except with respect to federally owned or operated facilities) are to be considered governmental response costs incurred pursuant to §9604. If sufficient funds are not available out of the Superfund for such indemnification payments or if the legislation authorizing the Fund has been repealed, the needed funds are authorized to be appropriated.[188]

The amendment provides that an indemnification agreement may be provided if the liability covered by the agreement exceeds or is not covered by insurance at a fair and reasonable price at the time the contractor enters into the response action contract, and adequate insurance to cover such liability is not generally available at that time. The RAC must have made diligent efforts to obtain such coverage from non-federal sources, and when a response action contract covers more than one facility, the RAC agrees to continue such diligent efforts each time it begins work at a new facility.[189]

The liability under indemnification agreements is limited to RAC liability resulting from a release arising out of response activities. Such indemnification agreements are to include deductibles, and are to provide for limits on the amount of indemnification.[190]

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[185] CERCLA §119(a)(1), 42 U.S.C.A. §9619(a)(1).

[186] CERCLA §119(a)(2), 42 U.S.C.A. §9619 (a)(2).

[187] CERCLA §119(a)(3)(4), 42 U.S.C.A. §9619(a)(3)(4).

[188] CERCLA §119(c)(3), 42 U.S.C.A. §9619(c)(3).

[189] CERCLA §119(c)(4), 42 U.S.C.A. §9619(c)(4).

A RAC carrying out a written contract with a potentially responsible party may also obtain an indemnification agreement if the President determines that the amount the potentially responsible party is able to indemnify is inadequate to cover any reasonable potential liability of the RAC arising out of its negligence in performing the contract with the PRP. In making this determination of the adequacy of available indemnity, the President is to take into account the total net assets and resources of the PRPs with respect to the facility at the time of the determination. However, the payment of indemnification under RAC-PRP agreements is limited by the requirement that before such a payment is made, the RAC must have exhausted "all administrative, judicial, and common law claims for indemnification against all potentially responsible parties participating in the clean-up of the facility ...."[191] The indemnification agreement, moreover, must require the RAC to pay any deductible established in such an agreement before it may recover any amount from the PRP or under the indemnification agreement.[192] The indemnification provision does not extend to owners or operators of facilities regulated under RCRA.[193]

Persons who are retained or hired by an RAC are eligible for indemnification only if the hiring was specifically approved by the President -- i.e., employees or subcontractors are included in an indemnification agreement only if such inclusion is expressly approved.[194] For purposes of liability and cost recovery under CERCLA §107, amounts expended for indemnification of any RAC are to be considered a cost of response incurred by the U.S. with respect to such release.[195]

Section 119 authorizes the promulgation of regulations relating to indemnification. Before regulations are promulgated, guidelines are to be developed and the development of such guidelines is to provide reasonable opportunity for public comment.[196] Section 119 also requires the Comptroller General to conduct a study in the fiscal year ending September 30, 1989, on the application of the provision. Such a study is to include the number of indemnification agreements, the number of claims filed under such agreements, and a consideration of the need for the indemnification authorization. The findings are to be reported to Congress no later than September 30, 1989.[197]

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[190] CERCLA §119(c)(5)(A),(B), 42 U.S.C.A. §9619(c)(5)(A),(B).

[191] CERCLA §119(c)(5)(C), 42 U.S.C.A. §9619(c)(5)(C)

[192] Id.

[193] CERCLA §119(c)(5)(D), 42 U.S.C.A. §9619(c)(5)(D).

[194] CERCLA §119(c)(5)(E), §119, 42 U.S.C.A. §9619(c)(5)(E).

[195] CERCLA §119(c)(6), 42 U.S.C.A. §9619(c)(6).

[196] CERCLA §119(c)(7), 42 U.S.C.A. §9619(c)(7).

The authorization of indemnification of RAC's in §119 has been clearly circumscribed to prevent a claim for indemnification by potentially responsible parties, namely owners, operators, transporters, and persons who arrange for disposal of hazardous substances as defined in §107(a)(1),(2),(3), and (4) of the Act.[198]

Miscellaneous Statutory Indemnities

In addition to authorization for contractual indemnities, the government provides indemnities to persons in a variety of callings that may have been injured by government regulatory programs. Indemnities are provided for producers of cotton who suffer loss as a result of cotton insect eradication programs.[199] The government provides indemnities to dairy farmers whose milk was removed from commercial markets because of chemical residue contents.[200] So too, manufacturers and dealers in pesticides are indemnified by the government for losses occurring through the cancellation or suspension of registration of the pesticide they produce or sell.[201]

Recurring Provisions in Contractural Indemnity Legislation

The table on the following page summarizes the recurring provisions in indemnification legislation covered in this paper. It seems that the pattern for requirements for indemnification was established largely by the National Defense Contracts Act and the related Executive Order in 1958. Some of what is reflected in the Act and Executive Order was required even earlier in 10 USC §2354, indemnification in R&D contracts for military departments. As noted earlier, indemnification authorization in HHS contracts for research and investigation expressly tracks the provisions of 10 USC §2354.

In general, indemnification covers all losses and liabilities not covered by the contractor's insurance. This includes expenses of litigation and settlement. In general, too, there is no coverage for losses or claims caused by willful misconduct or lack of good faith on the part of the contractor. Some of the laws also protect against

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[197] CERCLA §119(c)(8), 42 U.S.C.A. §9619(c)(8).

[198] CERCLA §119(d), 42 U.S.C.A. §9619(d) referring to 42 U.S.C.A. §9619(a)(1)(2)(3) and (4). Section 119 also provides that RAC's, subcontractors for program management, construction management, and the other listed services are to be selected in accordance with Title IX of the Federal Property and Administrative Services Act of 1949, and the Federal selection procedures are to apply to appropriate contracts negotiated by all Federal governmental agencies involved in carrying out the chapter. CERCLA §119(f), 42 U.S.C.A. §9619(f).

[199] 7 U.S.C. §1444a.

[200] 7 U.S.C. §450j.

[201] 7 U.S.C. §136m.

RECURRING PROVISIONS IN CONTRACTUAL INDEMNITY LEGISLATION

	10 USC §2354 Military R&D	National Defense Contracts Act	HHS Contracts for Research & Investigation	Nuclear Price Agency	Contract Settlement Act of 1944	Federal Aviation Act as Amended	NASA	VA Department of Medicine & Surgery	International Communication Agency	Council on Arts and Humanities	EPA Superfund
Nature of Risk	Unusually Hazardous	Unusually Hazardous or Nuclear	Unusually Hazardous	Extraordinary Nuclear Occurence		War Risk-International Aviation Risk	Unusually Hazardous Risk	Unusually Hazardous	Injury to Person or Property		
Indemnity to apply to losses not compensated by insurance: expenses of litigation and settlement, third party claims, personal injury and property damage or loss of contractor or government subcontractors	x	x	x				x (In excess of 500,000)	x			x Liabilities incurred by response action contractors
No coverage for losses, claims caused by willful misconduct or lack of good faith		x (by regulation)		x (if nuclear incident, exemption applies, but not if extraordinary occurence)			x				x (Grossly negligent or intentional misconduct)
U.S. right to have notice, intervene, litigate or settle	x	x (by regulation)	x				x	x			x
Risks covered only if not covered under state or Federal workers' compensation or injury compensation laws		x (by regulation)						x			
Annual Report to Congress required		x									
Amount of indemnity "just and reasonable"	x		x				x	x			

double recovery by excluding risks covered under state or Federal workers' compensation or injury compensation laws. A number of the laws also require certification by the agency that the amount of the indemnity is "just and reasonable." This appears to be a somewhat superflous requirement, because under other laws, if the conditions of indemnification are met, the amount of the indemnity is very likely to be just and reasonable whether or not so certified.

Some of the Federal indemnification laws deviate from the general pattern, at least in so far as formal requirements for indemnification are concerned. Under the Price-Anderson, prior to its amendment in 1988, indemnity is strictly limited to major accidents encompassed in the term "extraordinary nuclear occurence." The law itself sets insurance requirements and makes clear that Federal indemnity is applicable only above the private insurance coverage. There is one peculiar departure from the general pattern with respect to coverage for losses or claims caused by willful misconduct or lack of good faith. The the case of extraordinary nuclear occurences, i.e., in the case of major accidents, the contractor's responsibility is not considered, but if the accident merely qualifies as a nuclear incident -- i.e., a case of less horrendous consequences -- then willful misconduct or lack of good faith excludes government indemnity. Other special cases which do not follow the general pattern include the Contract Settlement Act of 1944, which reflects an urgent desire to dispose of government obligations growing out of World War II, without imposing any express conditions on the process. Other laws, such as indemnifications in International Telecommunications and in the case of obligations of the Council on Arts and Humanities cover rather narrow areas and the limited application of these laws apparently makes some of the broad restrictions and limitations less necessary or desirable.

A slightly different pattern is found in the more recent 1986 Amendment of the Superfund law relating to indemnification resulting from cleanup operations of hazardous waste sites. While the application of the indemnities is substantial and broad and largely follows the provision first set down in the National Defense Contracts Act, it may require the response action contractor to exhaust the possibility of collecting on its claims against other "potentially responsible parties" under the law. Unlike earlier laws which denied coverage of losses and claims caused by willful misconduct or lack of good faith, the Superfund law denies the recovery to contractors who have been grossly negligent or who have engaged in intentional misconduct.

Policy Considerations in the Provision of Indemnities

Authorization for contractual indemnification has not been developed in accordance with an overall plan or pattern, but has responded to particular needs and exigencies. The availability of contractual indemnification is a benefit the government bestows on a limited number of groups and callings. Indemnities have been used quite regularly to induce defense contractors to engage in production or services for the government which may subject the contractor to claims and potential liabilities not shared by other manufacturers and providers. Ordinary services, such as transportation services rendered by commercial airlines, were selected for indemnification when, in the national interest, airlines had to assume unusual risks, such as war risks, in flying their routes. In many instances the indemnification of a dangerous activity carried out under contract is justified not because the contractor is under any obligation to assume the risky contract, but because the Congress has declared that undertaking the risky activity advances the national interest of the country. Thus, indemnification for the risks of nuclear power production was legislatively justified on the grounds that the country needed the additional power for its economic development, growth and welfare. In the case of the national space program, indemnification of contracts involving substantial hazards was justifiable both in terms of national security and economic development.

Indemnification of shortwave radio facilities and stations, and of persons and organizations that lend valuable art works and other objects for exhibition here and abroad, can be seen as an effort to improve the international relations of the United States and to contribute to international amity.

In the case of government indemnities in the public health area, such as for participants and contractors in the swine flu immunization program, or for experimental and other activities carried out in veterans hospitals, the purpose is to hold harmless contractual participants in the rendition of public health services that Congress supports in the public interest where the public risks and liabilities might otherwise dissuade participants. The Swine Flu program, which was not by its terms an indemnity program, interestingly provided an alternative to the provision of indemnities. When a project is considered of such overwhelming national interest that it should be undertaken regardless of liabilities, direct government responsibility is an alternative to indemnity.

IV. PROCEDURAL ASPECTS OF ENTERING INTO CONTRACTUAL INDEMNITIES

Laws that authorize the inclusion of indemnities in government contracts are not self-executing. All of them state the conditions that must be met before contractual indemnity will be granted, and they also designate the official who must determine that the conditions -- usually involving unusual risks, or risks that cannot be covered by commercially available insurance -- have been met.

Another element to be considered is that government procurement of products and services is subject to a variety of detailed regulations that not only aim at providing for the government the best products and services at the least cost, but that also serve many other policy purposes -- such as preference for small businesses, preferences for minority businesses, preferences for reclaimed, rather than virgin materials, exclusions of bidders who have violated environmental laws, compliance with affirmative action requirements for handicapped workers, for disabled veterans, and many others. Thus, the procurement of services and products has long been the subject of detailed procurement codes and regulations, in which the provisions relating to the inclusion of contractual indemnities are [illegible] used to advance certain policies.

The mass of procurement regulations hav[illegible]rgone significant rearrangement, moreover, in 1984. On September 19, 1983,[202] the General Services Administration, the Department of Defense and the National Aeronautics and Space Administration issued a joint document establishing a new Federal Acquisition Regulation (FAR) codified in Chapter 1, Title 48, of the Code of Federal Regulation, leaving chapters 2-4a of Title 48 for individual agency implementations and supplementations of FAR. Thus, FAR in Chapter 1 and Chapters 2-49 of Title 49 of CFR comprise the Federal Acquisition Regulations System that went into effect on April, 1984.[203]

The new FAR system replaced both the earlier Federal Procurement Regulations System (FPRS) for civilian contracts,[204] and the Defense Acquisition Regulations (DAR) for defense contracts.[205] These earlier regulations remain a part of the Code of Federal Regulations, however, because both the DAR and FPR provisions continue to apply to contracts which preceded April 1, 1984, the effective date of the FAR.[206]

In general, the indemnity provisions in the FAR and in the contract clauses that incorporate the undertaking by government to provide contractual indemnity follow both the statutory authorization and the statutory language, offering very few elaborations. The language of the regulations, moreover, is not subject to court review in the usual sense, because the grant or denial of a contractual indemnity is not subject to judicial review. The interpretation of the language by the public official administering it is final, subject only to a corrective revision of the authorizing legislation by Congress.[207]

Indemnity Regulations Under Pub. L. No. 85-804

The most broadly applicable regulation on contractual indemnities relates to indemnification under Pub. Law No. 85-804, the National Defense Contracts Act,[208] which covers a long list of government departments and agencies, both military and civilian, that have significant national defense functions. Indemnity clauses may only be included in such agencies' contracts when this would advance the national defense.[209] The authority to enter into such contracts can only be granted to the Secretary or Administrator of the agency concerned.[210] Indemnification agreements authorized by an agency head are not limited to amounts appropriated or to contract authorization.[211]

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[202] 48 Fed. Reg. 42103 (1983).

[203] 50 Fed. Reg. 26987 (1985).

[204] 41 C.F.R. Subtitle A, Chapters 1-49.

[205] 32 C.F.R. Chapter 1, (arts. 1 to 39).

[206] *Id.*, at 20968.

[207] This has been a subject of critical comment in Congressional testimony on newly proposed legislation.

[208] *Supra*, at N. 29.

Indemnification Requests

Contractors requesting indemnification contracts under P.L. 85-804 must supply certain information to the contracting officer. First, the contractor must identify and define the unusually hazardous or nuclear risk and state how the contractor would be exposed to such risk.[212] Second, since the indemnification applies only to the extent that the claim is not compensated for by insurance, the contractor must furnish a statement disclosing all insurance coverage applicable to the stated risk. This requirement includes disclosing the names of insurance companies; description of types of insurance; dollar limits per occurrence; deductibles if any; any exclusions from coverage; and any applicable workers' compensation insurance coverage.[213] The contractor must also disclose the controlling factor for determining the amount of coverage, and the availability, cost, and terms of additional insurance.[214] If the contractor is part of a parent corporation it must supply the contracting officer with the precise legal relationship between the companies and reveal whether the parent company has insurance coverage that bears on the risks for which the contractor seeks indemnification.[215]

Third, if the contractor has entered into other government contracts which provide for indemnification against similar risks the contractor must report this information with a description of any limitations contained in those contracts.[216]

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[209] 48 C.F.R. 50.101; the Government Printing Office; the Federal Emergency Management Agency; the Tennessee Valley Authority; the National Aeronautics and Space Administration; the General Services Administration; the Defense, Army, Navy, Air Force, Treasury, Interior, Agriculture, Commerce, and Transportation Departments; the Department of Energy.

[210] 48 C.F.R. 50.201.

[211] 48 C.F.R. 50.203.

[212] 48 C.F.R. 50.403-1(2).

[213] 48 C.F.R. 50.403-1(3).

[214] 48 C.F.R. to.403-1(4).

[215] 48 C.F.R. 50.403-1(6).

[216] 48 C.F.R. 50.403-1(5).

Agency Action

The contracting officer is authorized to review the request and to determine whether all of the conditions have been met.[217] Any recommendation for approval to the agency head must include a definition (to which all parties have agreed to) of the unusually hazardous or nuclear risks and the following statements by the contracting officer: 1) that the contract would facilitate the national defense, 2) that the defined risk could expose the contractor to liabilities in excess of insurance coverage; 3) that the contractor is complying with all applicable safety requirements and 4) whether the indemnification would be extended to subcontractors.[218]

In deciding whether to approve the request for an indemnification clause "an agency head shall consider such factors as self-insurance, to extend indemnification to subcontractors, other proof of financial responsibility, workers' compensation insurance, and the availability of private insurance."[219] Approval of the recommendations is issued in a Memorandum of Decision.[220] Only then can the contracting officer enter into agreement with the contractor using the same procedures as those required for entering agreements with other contractors.[221]

The contract clause for Indemnification Under Public law 85-804, provides that the Government will indemnify the contractor against claims by third persons for death; personal injury; or loss of, damage to, or loss of use of property; and will indemnify the contractor for any loss of, damage to, or loss of use of the contractor's property.[222] The clause provides that the indemnification is limited to claims arising out of the risk defined in the contract that are not compensated for by insurance or otherwise.[223] If the claim results from willful misconduct or lack of good faith on the party of the contractor, the contractor will not be indemnified for its own property loss or for any government claims against the contractor (other than through subrogation).[224]

Claiming Indemnification

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[217] 48 C.F.R. 50.403-2.

[218] 48 C.F.R. 50.403-2.

[219] 48 C.F.R. 50.401.

[220] 48 C.F.R. 50, 403-2(7)(b).

[221] 48 C.F.R. 50.403-2.

[222] 48 C.F.R. 52.250-1(b).

[223] 48 C.F.R. 52.250-1(c).

[224] 48 C.F.R. 52.250-1(d).

The contractor must promptly notify the contracting officer of any claim that may be expected to involve indemnification.[225] This includes supplying all pertinent papers the contractor receives and evidence of any claim of loss and how it may be covered under the contract.[226] The contractor is required, by contract, to comply with any government directions regarding the settlement or defense of the claim.[227] The indemnification clause provides that the government may direct, control or assist in the defense or settlement of any claims or actions.[228]

Agencies are required to maintain complete records of all indemnity actions taken pursuant to P.L. 85-804, and they must also report to Congress annually on actions taken on requests for relief under the Act, including indemnification.[229] The agency is required to retain for each request for relief processed: 1) the contractor's request; 2) the Memorandum of Decision; 3) a copy of the contract; and 4) all relevant memorandums, correspondence, affidavits, and other pertinent documents. The annual reports required under the Act show that no claims for indemnification were made in the last five years, and appropriate personnel in DOD and DOJ cannot remember any such claims in the past.[230]

Agency Regulations

Agencies authorized to execute indemnity agreements under the Act include NASA, DOD and DOE.[231] NASA had adopted its own procedures for entering into indemnification agreements with government contractors.[232] For example, in addition to the FAR procedures for requesting indemnification, NASA requires a contractor to include copies of all relevant third party comprehensive liability policies and product liability policies or the equivalent.[233]

NASA provides the contracting officer with a standard definition of "unusually hazardous risks" to be used in the government contracts (unless the Administrator approves a different definition to be used in a particular contract.)[234] NASA also provides a contract clause to be used in place of the clause provided by FAR. This clause differs in that under NASA's indemnification clause the government shall only be liable for loss in excess of the contractor's insurance or $500,000.000 whichever is the larger amount.[235] The contract clause used by FAR does not impose any limits on appropriation.[236]

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[225] 48 C.F.R. 52/250-1(g).

[226] 48 C.F.R. 52.250-1(g).

[227] 48 C.F.R. 52-250-1(g).

[228] 48 C.F.R. 52-250-1(h).

[229] 48 C.F.R. 50.104.

[230] 48 C.F.R. 50.105. See text at N. 345 *infra*.

[231] 48 C.F.R. 50.101.

[232] 48 C.F.R. 1850.403.

[233] 48 C.F.R. 1850.403.

The Defense Department's use of indemnification under P.L. 85-804 is limited to situations when the contract cannot be indemnified under 10 U.S.C. §2354, (which governs military contracts for research and development) and meets all the requirements prescribed by FAR.[237] The authority granted by P.L. 85-804 may be used to provide indemnification in contracts involving unusually hazardous risks in both research and developmental work as well as for work that cannot be so classified.[238]

The Department of Energy is authorized to execute agreements under the Act only for functions transferred to that Department from another authorized agency.[239]

Department of Energy -- Indemnity Regulations Under Atomic Energy Act

Section 170d of the Atomic Energy Act of 1954 authorizes DOE "to enter into agreements of indemnification with its contractors for the construction or operation of production or utilization facilities or other activities under contracts for the benefit of the United States involving activities under the risk of public liability for a substantial nuclear incident."[240]

The Department of Energy has established the "Department of Energy Acquisition Regulation" (DEAR).[241] The Heads of the Contracting Activities are authorized to enter into indemnity contracts whenever it has been determined that the contractor is under the risk of public liability for the occurrence of a substantial nuclear incident in the course of performance of the contract work or for a substantial nuclear occurrence caused by a product delivered under contract.[242] The determination is based on a detailed study to determine the maximum conceivable damage which could result from a nuclear incident arising out of the contractor's activities.[243] If the maximum conceivable damage is $60 million or more the Head of the Contracting Activity may approve the use of an indemnity clause.[244] Between $1 million and $60 million the request for indemnity must be approved by the Agency Head. Under $1 million the contractor does not qualify for indemnity under the Atomic Energy Act of 1954.[245]

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[234] 48 C.F.R. 1852.250-72.

[235] 48 C.F.R. 1852.250-70(b)(1)(iii).

[236] 48 C.F.R. 50.203.

[237] 48 C.F.R. 235.070.

[238] 48 C.F.R. 250.403-70.

[239] 48 C.F.R. 50.101.

[240] 42 U.S.C. §2014(j); 42 C.F.R. 950.7003.

[241] 49 Fed. Reg. 11936 (1984); 48 C.F.R. 901.101 et seq.

[242] 48 C.F.R. 950.7004.

The Act also authorizes the indemnification of all subcontractors, vendors and suppliers under the prime contract.[246] This includes contracts for: operating a production or utilization facility on its completion; architect-engineer services; component parts for a production or utilization facility; construction at a production or utilization facility, where the work does not entail a substantial risk; and equipment or services which would be part of or contribute to the construction or operation of a production or utilization facility.[247]

Indemnification under the Atomic Energy Act

The regulatory analysis that follows does not reflect any changes following the amendment of the Price-Anderson Act in 1988, earlier described. DOE will indemnify against claims for public liability and the reasonable cost of investigating and settling claims and defending suits if the incident is not covered by any other indemnity agreement entered into by DOE or the NRC. DOE's liability under all contracts entered into under section 170 of the Act shall not exceed $500 million (the statutory maximum) in the aggregate for each nuclear incident occurring within the U.S. or $100 million in aggregate for each nuclear incident occurring outside of the U.S. irrespective of the number of persons indemnified under the contract.[248]

Different indemnification clauses are provided for different kinds of DOE contracts, for general contract work, including the construction or operation of a nuclear power plant;[249] Another clause provides indemnity for product liability;[250] and a third clause provides indemnity for architect-engineers or suppliers.[251] Though the clauses follow the same general structure, only contracts for construction and operation require the contractor to waive the defenses listed in the Atomic Energy Act in the event of an extraordinary nuclear incident,[252] there are significant differences of coverage and in the amount of indemnity.[253] In the case of the general contract indemnity, coverage for claims involving willful misconduct will depend on whether it is characterized as a "nuclear incident" or as an "extraordinary nuclear incident."[254]

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[243] 48 C.F.R. 950.7005.

[244] 48 C.F.R. 950.7005.

[245] 48 C.F.R. 950.7005.

[246] 48 C.F.R. 950.7008.

[247] 48 C.F.R. 950.7007.

[248] 48 C.F.R. 952.250.70(c)(1).

[249] 48 C.F.R. 952.250-70.

[250] 48 C.F.R. 952.250-71.

[251] 48 C.F.R. 952.250-72.

Claiming Indemnification

The contractor must give DOE notice of any claim made against the contractor or any other person included in the contract and furnish DOE with any pertinent papers received by the contractor or filed with respect to such claims or actions.[255] DOE has the right to require prior approval for the payment of any claim and to appear through the Attorney General on behalf of the contractor or other persons indemnified.[256] Through the Attorney General DOE may take charge of the settlement or defense of the action.[257]

When statutory indemnity under the Atomic Energy Act does not cover the contract, the Agency Head may authorize the Head of the Contracting Activity to offer the contractor a general authority indemnity agreement.[258] Alternatively the Head of the Contracting Agency is authorized to offer the contractor nuclear liability insurance.[259] DOE contractors covered by the Atomic Energy Act are generally not required or permitted to carry insurance against public liability for nuclear accidents unless they do not qualify for indemnity.[260] In that case the insurance must also be approved by the Office of Industrial Relations and cannot exceed $1 million in coverage.[261]

If DOE is extending indemnification under its general authority, the amount of protection is subject to the availability of appropriated funds.[262] Normally the amount is equivalent to the amount of insurance the contractor would carry in its other commercial operations for similar risks.[263] If the contractor has been extended both statutory indemnity and general authority indemnity, the general authority indemnity will not apply to the extent that the statutory indemnity applies.[264]

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[252] 42 U.S.C. §2210(n)(1987).

[253] Compare 48 C.F.R. 952.250-70 and 48 C.F.R. 952.250-71.

[254] 48 C.F.R. 952.250-70.

[255] 48 C.F.R. 952.250.70(f).

[256] 48 C.F.R. 952.250.70(f)(1).

[257] 48 C.F.R. 952.250.70(f)(2).

[258] 48 C.F.R. 950.7011(a).

[259] 48 C.F.R. 950.7011(d).

[260] 48 C.F.R. 950.7011(d).

[261] 48 C.F.R. 950.7010(a).

NASA - Contractual Indemnity

NASA treats contractual indemnities as part of its regulation of Extraordinary Contractual Actions.[265] NASA has decided not to use the "residual powers" authorized by the National Defense Contracts Act and by FAR, Subpart 50.4, and not to include in its contracts the clause authorized under Pub. L. No. 85-804.[266] NASA has thus determined to use its own indemnification regulations and is own contract clause.

Contractor requests for the exercise of the indemnification authority are to be forwarded to the Assistant Administrator for Procurement, who, in turn must review it and forward the contractor request "through channels to the administrator for approval."[267] If the Administrator approves, he signs a Memorandum of Decision. The information that must be submitted is the same as required by FAR, and in addition, the information must also include a copy of relevant third party comprehensive liability policies and product liability policies.[268] The Contract clause for NASA contracts cross-refers to a number of FAR and Pub. L. 85-804 clauses,[269] but requires the addition of a special clause, on Space Activity-Unusually Hazardous Risk.[270]

When an indemnification provision is included in any NASA prime contract pursuant to the authority of the Administrator's Memorandum Decision, the contracting officer must submit a report directly to the Contract Adjustment Board, including two copies of the Memorandum Decision; two copies of any clause which deviates from the indemnification clauses prescribed, and complies with the Requirement of Public Law No. 85-804 and the Executive Order 10789 (i.e. the requirements similar to FAR).[271] The Contract Adjustment Board must retain these submissions.[272]

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[262] 48 C.F.R. 950.7011(b).

[263] 48 C.F.R. 950.7011(e).

[264] 48 C.F.R. 950.7011(g).

[265] 48 C.F.R. Part 1850.

[266] 48 C.F.R. 52.250.1.

[267] 48 C.F.R. 1856.402

[268] 48 C.F.R. 1850.403-1(a).

[269] 48 C.F.R. 1850.403-3.

[270] 48 C.F.R. 1852.250-72. See N. 262 *infra*.

EPA Indemnification of Superfund Response Action Contractors Under §119 of the Superfund Law

To carry out the authorization of §119 of the Superfund law as added by §119 of the Superfund Amendments and Reauthorization Act of 1986 (SARA),[273] EPA has adopted an interim guidance document. The interim guidance is addressed to Regional Administrators and Directors of Toxics and Waste Management Divisions to provide detailed guidance for the exercise of authority to indemnify response action contractors (RACs) working for EPA and for other federal agencies.[274]

The interim guidance provides for indemnification for RACs working at Superfund sites for states, for potentially responsible parties (PRPs) and for EPA, including RACs working for the U.S. Army Corps of Engineers.

In its background information, the interim guidance notes:

> Prior to the reauthorization of CERCLA, EPA provided indemnification to RACs working for EPA through contract authority implementing CERCLA. EPA took this step in order to retain qualified contractors, given the absence of pollution liability insurance coverage. Under this old indemnification agreement, the federal government indemnified RACs above an initial $1 million for third party liabilities and defense expenses. The indemnification agreement was void in case of gross negligence or willful misconduct.[275]

Noting that §119 of SARA responds to many of the concerns of the RAC community, it states that the section establishes a standard of negligence for actions brought against RACs under federal law. If an action is brought under state law, however, a strict liability standard could apply. The guidance reiterates the provision of limited indemnification against pollution liability arising from RAC negligence on a discretionary basis. The interim guidance then recites the limits and deductibles under statutory indemnification provisions, and asserts that RAC indemnification provides an adequate substitute for insurance. It asserts that, "discretionary indemnification is an interim vehicle that will keep the Superfund program operative until the insurance industry returns to the RAC liability insurance market; and discretionary indemnification does not create a federally intrusive insurance program that interferes with private sector efforts to develop RAC liability insurance coverage."[276]

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[271] 48 C.F.R. 1850.403-70.

[272] 48 C.F.R. 1850.403-70(b).

[273] See text at N. 174 supra.

[274] The authority to indemnify RACs working for other agencies is provided by Executive Order 12580.

[275] EPA Interim Guidance on Indemnification of Superfund Response Action Contractors Under 119 of SARA (Oct. 6, 1987), at 2.

Noting the establishment of an EPA task force on RAC indemnification, the interim guidance states that the purpose of the task force, including the establishment of a RAC indemnification program, the development of final indemnification guidelines and regulations, the establishment of a forum for public comment on RAC indemnification, and the promotion of private sector provision of RAC pollution liability insurance by providing technical assistance to the insurance industry.

Authorization to provide indemnification under the EPA interim guidance will be made by the EPA OSWER--Office of Solid Waste and Emergency Response--with the concurrence of the Office of the Comptroller. Authorization to indemnify is to be made upon receipt of a recommendation from the task force, and the Office the Comptroller (OC) will provide concurrence or nonconcurrence with recommendations to indemnify within 7 calendar days of receipt of a recommendation.

In carrying out the requirements of §119, EPA plans eventually to promulgate guidelines for determining whether insurance is "generally available" or is "fairly and reasonably priced."

For the purpose of this interim guidance, EPA has determined, based on information currently available that Superfund RACs are unable to obtain reasonably priced pollution liability insurance. Therefore, RACs are eligible to receive indemnification under §119 from DOE (date of exactment) of SARA. However, EPA will require that RACs, seeking federal indemnification meet the following requirements:

- The interim guidance then lists the evidence the RAC must submit to EPA demonstrating efforts to receive liability insurance, and the kind of documentation that is necessary in the event of obtaining such coverage. When no insurance has been obtained, EPA may require the RAC to submit to EPA or to the state contracting officer demonstrating additional efforts made to obtain such liability insurance. Other documentation that must be presented includes reports of liability insurance coverage offered to but not accepted by the RAC, and a status report concerning the alternative pollution liability risk transfer mechanisms which the RAC has pursued other than commercial pollution liability insurance, including risk retention groups, purchasing groups and association captives.
- The interim guidance provides that pre-SARA indemnification terms will apply to work performed at a site after the enactment date of SARA if response action at the site is initiated prior to the date of enactment. New indemnification agreements are provided for for RACs currently working under a contract with EPA for work they will initiate at a new site after the date of enactment.
- Separate provisions are made for indemnification of RACs working for states. In general the provisions parallel the provision of RACs working for EPA, in that EPA may indemnify RACs performing response

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[276] *Id*.

action activities for a state at a state-led Superfund site after the date of enactment of SARA. The RAC must meet all of the requirements relating to efforts to obtain liability insurance coverage and it must meet the requirements of §119(c)(4) which also refers to indemnification in the absence of appropriate insurance availability. Such RACs would also be subject to the limits, deductibles and other restrictions as provided in §119(c)(5). Again, indemnification for RACs will not be available for site work performed prior to the effective date of SARA.

The interim guidance provides for the processing of indemnification request through the Task Force until final guidance and regulations are issued. Other temporary provisions on the routing of indemnification requests are also included.[277]

Provision is made also for indemnification of RACs working for other federal agencies. The President authorized other federal agencies to use §119 on January 26, 1987 by Executive Order. The provisions applicable to RACs working for EPA apply, except that other federal agencies that use §119 authority must provide their own source of funds to pay indemnification costs. RACs working as contractors for the Corps of Engineers at a Superfund site pursuant to an interagency agreement with EPA where the site is listed on the National Priority list are considered to be working for EPA rather for than some "other federal agency," and will be offered the same indemnification as if they were working for EPA itself.

The interim guidance notes that §119(c)(2) authorizes EPA in limited circumstances to indemnify RACs which perform response action activities for potentially responsible parties (PRPs) subject to a consent order or decree at Superfund sites after the date of enactment of SARA. The interim guidance notes that EPA will use its authority to indemnify RACs working for PRPs only where such indemnification is the solution of last resort. The interim guidance requires that all the conditions regarding efforts to obtain private insurance must be met, as well as all other interim guideline requirements previously mentioned, and in addition, that the PPPs are unable to provide adequate indemnification, and as a result are unable to obtain the services of a qualified RAC, and further that the RAC response action is part of new site work initiated at a Superfund site after a date of enactment of SARA, and that such response action is related specifically to the clean up of the site. Such indemnification will not be offered for work performed for PRPs prior to the SARA date of enactment, nor for any response activity not specifically related to a remedy at a Superfund site. The interim guidance also states that §119(c)(5)(C) of SARA requires that before EPA can enter into an indemnification agreement with a RAC performing work under a contract with PRPs at a Superfund site, it must determine the amount which the PRP is able to indemnify the RAC. After taking net assets and resources of the PRP into account, EPA may provide the indemnification if it determines that the amount that the PRP is able to indemnify the RAC is inadequate. EPA must consider the combined capabilities of all the PRPs at a site to determine whether as a group they are capable of providing adequate coverage. The guidance document notes that in general the agency expects to use this provision only in cases where PRPs are small firms with few assets. Where PRPs are large corporations with substantial assets or where the group as a whole has substantial assets, regions should not make requests for federal indemnification. EPA consequently does not expect requests for federal indemnification to become an integral part of settlement negotiations. EPA promises to provide additional guidance in the future relating to the determination of net assets and resources before ability to provide adequate indemnification may be ascertained. Until such time as such guidance is forthcoming, the determination is to be made by the Task Force.

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[277] Id. at 8.

The interim guidance notes that EPA indemnification of a RAC working for a PRP is a measure of last resort. In cases where EPA does provide such indemnification, the consent of decree or order should specify the terms and conditions, using the applicable model EPA indemnification·agreement which is part of the interim guidance document. When EPA enters into an indemnification agreement with a RAC working for PRPs, the RAC must retain financial responsibility for a deductible amount if commercial insurance is unavailable or unreasonably priced. The RAC must also exhaust all administrative, judicial and common law claims for indemnification against all PRPs participating in the cleanup before EPA can pay a claim. EPA may also provide indemnification in cases where a RAC has received partial indemnification from PRPs which EPA deems insufficient, and in mixed funding cases (i.e., cases in which remedial costs are met in part from the Superfund and in part by PRPs). In all such cases, the model EPA indemnification agreement is to be used in the consent decree in specifying the terms and conditions. Requests for such indemnification in cases of RAC working for PRPs are to be submitted to both the indemnification task force and to the regional Superfund coordinator and the regional counsel's site representative. The task force will then evaluate the amount to which the PRP is able to indemnify the RAC and an amount to which EPA will indemnify the RAC in excess of the PRP indemnification, subject to the limits, deductibles and limitations required by §119(c)(5).

The interim guidance provides recommended arrangements for RACs working for PRPs without indemnification. Such RACs may receive no indemnification at all or may receive indemnification from PRPs only. For RACs working with no indemnification, PRPs should show that the RAC is qualified, has sufficient financial capability to complete the work, and demonstrates financial responsibility for potential third party liability costs. Demonstration of financial responsibility may consist of a purchase of performance bonds, letters of credit, insurance, terms, the maintenance of a trust fund or by other means. The consent degree should provide the appropriate specifications.

For RACs receiving indemnification from PRPs only, where EPA deem such indemnification to be adequate, the RACs should be qualified to perform the work adequately. The PRP indemnification in such instances is sufficient demonstration of financial responsibility, and no further demonstration of financial responsibility will be required. The consent degree should specify the circumstances as well as the terms and conditions of indemnification.

The interim guidance determines that EPA will not indemnify the owner of operator of a facility regulated under RCRA. This will be the case whether the specific prohibition of §119(c)(5)(D) applies or whether the POTW is not subject to a RCLA because it operates without a permit by rule. Though such POTWs are not expressly excluded under §119, EPA has determined that it will not extend such indemnification because the intent of the provision is to prohibit EPA from offering indemnification to off-site treaters or disposersof Superfund hazardous waste.

In summary, the interim guidance recites that indemnification is not to be provided for acts of gross negligence, and willfull misconduct and that the §119 indemnity provision does not preempt the rights of states to enforce a standard of strict liability. The interim guidance concludes, "federal indemnification is meant to be an interim vehicle which will keep the Superfund program operative until the insurance industry returns to the market. It is not intended to create a federally intrusive program that will interfere with private sector efforts to develop RAC liability insurance coverage."[278]

The interim guidance contains a series of attachments consisting of model EPA indemnification agreements for use by EPA, states, and PRPs when RACs seek indemnification from EPA. The introduction to the model agreements notes that any deviation from the model language must be approved by the EPA indemnification task force.[279]

Veterans' Administration -- Indemnification of Contractors in Medical Research or Development Contracts

For contracts authorized by 38 U.S.C. §4101, indemnification may be provided for physical injury and property damage from risks defined as unusually hazardous in the contract.[280] Such contracts must provide for prompt notification of claims, and at the government's election for government control or assistance, in the defense or settlement of the claim.[281] Contractors are required to maintain the maximum amount of private liability insurance available to cover the risk, unless the Administration establishes a lesser amount. Government indemnity is then applicable in excess of the private coverage. The request for approval of indemnification must by made to the contracting officer, and then goes to the Director, Office of Procurement and Supply, for final transmittal to the Director.

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[278] *Id.* at 12.

[279] *Id*. For additional information, see *EPA Superfund Program Response Action Contractor Indemnification/Insurance Briefing*, a detailed EPA briefing document.

[280] See text at N. 169 *supra*.

[281] 48 C.F.R. 828.702.

V. CURRENT AGENCY EXPERIENCE WITH CONTRACTOR INDEMNIFICATION

The Frequency and Use of Indemnity Clauses in Federal Contracts

While indemnity clauses in government contracts have been authorized for a variety of situations involving "unusually hazardous" circumstances, very few contractors secure the inclusion of indemnity clauses in their government contracts. The Department of Defense, which may indemnify contractors under Public Law 85-804 and under 10 U.S.C. 2354 for research and development contracts, has used this authority very sparingly.[282] Mary Ann Gilleece, Deputy Undersecretary of Defense for Acquisition Management, testifying before a Congressional committee, stated that indemnification provisions are used in:

> exceptional circumstances involving unusually hazardous or nuclear risks. Items that fall under the definition of 'unusually hazardous' are generally those associated with nuclear powered vessels, nuclear armed guided missiles, experimental work with nuclear energy, handling of explosives, or performance in hazardous areas. In addition, indemnification clauses are inserted in all transportation contracts entered into by the military airlift command for transportation services to be performed by air carriers that own or control aircraft which have been allocated by the Department of Transportation to a civil reserve air fleet. Indemnification clauses inserted into transportation contracts are authorized by Public Law 95-163.
>
> The use of indemnification provisions is very unusual. Provisions to indemnify contractors against liabilities because of death or injury or property damage arising out of nuclear radiation, use of high energy propellants, or other risks not covered by the contractor's insurance program have indeed been used very sparingly in the last five years:

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[282] See supra 10 U.S.C. 2354.

Calender Year	Contracts Providing for Indemnification
1980	65
1981	77
1982	93
1983	53
1984	50

> To put these numbers in perspective, the Department of Defense executed over 14.8 million contract actions in fiscal year 1984. Indemnification provisions were used in less than 1/1000 of 1% of those contract actions.[283]

In this as in other Congressional testimony, the Department of Defense has indicated that although indemnification provisions are used rarely they are essential to procuring the nation's defense systems. Indemnification assures that some of the nation's critical defense programs are executed in spite of extraordinary risks. "When we operate at the leading edge of technology we cannot expect the contractor to assume all the risk particularly when hazardous or nuclear risks are involved. We believe our indemnification procedures are a necessity and they are working well."[284]

The Department of Defense has reiterated and maintained its position that its authorities under Public Law 85-804 and 10 U.S.C. 2354 are adequate and that the Department is opposed to expanding the government's financial liability by additional indemnification legislation.[285] In response to a question, the Deputy Undersecretary of Defense indicated that no actual indemnification had taken place to her knowledge under any of the indemnification agreements entered into.[286]

A substantial number of DOD contracts that contain indemnity clauses relate to the construction of nuclear vessels. The application of indemnities in the case of nuclear vessels is significant because military uses of nuclear energy, including nuclear vessels, are not covered by the indemnity provisions of the Price-Anderson Act.[287]

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[283] Hearing before the Committee on the Judiciary, U.S. Senate, 99th Cong., 1st Sess. on S.1254 (June 11, 1985).

[284] Testimony and Statement of the same witness, Mary Ann Gilleece, Hearing before the Subcommittee on Administrative Practice and Procedure of the Senate Judiciary Committee, 98th Cong., 1st Sess. on S.1839, at 40-45 (Oct. 18, 1983). She indicated that for 1978 there were 75 indemnities authorized and for 1979, 127.

[285] Id., at 32.

[286] "Well, Mr. Chairman, essentially we know of no situation in which we have - well, indemnifying the contractor has actually paid them for a problem.[sic] I also indicated that 85-804 is available for the extracontractual relief." Id., at page 34.

Indemnity clauses are regularly used in the contracts of the National Aeronautic and Space Administration (NASA) for contracts that may potentially involve "unusually hazardous" risks. As defined by NASA, an unusually hazardous risk is a risk which exceeds the level of insurance available to the contractor.[288] NASA's primary authority to include indemnity clauses in its contracts relates to users of a space vehicle.[289] Thus the authority for indemnification is rather narrow in its application.

NASA did not authorize indemnity provisions in its contracts until January 19, 1983 when its Administrator in a memorandum decision under Public Law 85-804 authorized that certain NASA contractors be indemnified against designated risks. The authorization gave NASA contracting officers the authority to include provisions for the indemnification of the contractors and their subcontractors against defined losses.

The Administrator in the introduction to his decision provided a rationale for contractor indemnification. He recited that in July 1982 the shuttle completed its design development and evaluation phase and was declared an operational system of the United States for the transportation of payload into and out of space for governmental and commercial purposes. In consequence the Space Transportation System (STS) will conduct launch, in orbit and landing activities on a repetitive basis and with increasing frequency. This has dictated a reexamination of the risks in repetitive space activities and the availability of adequate insurance at reasonable premiums to manufacturers and operators of the system. While asserting the safety of space activities, "there exists the remote and low statistical probability that a malfunction of either hardware, software or operator error could occur resulting in an accident." This low probability, though remote, cannot be totally removed and if such liability arose, could be substantially in excess of the insurance coverage NASA contractors may reasonably be expected to acquire and maintain.

The authorization for indemnity was limited to prime contracts for the following purposes:

a) provision of space transportation and cargo flight elements or components thereof;
b) provision of space transportation system and cargo ground support equipment or components thereof;
c) provision of space transportation and cargo ground control facilities and services for their operation;
d) repair, modification overhaul support and services and other support and services directly relating to the space transportation system, its cargo and other elements used in NASA's space activities.

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[287] 42 U.S.C.A. §2140, 42 U.S.C.A. §2210(a).

[288] 48 C.F.R. 1852.250-7.

[289] 42 U.S.C. §2458b.

The indemnity is limited to claims or losses arising out of the use or performance of the products or services described in NASA's space activities, when used in such activities at the U.S. government installation in connection with a shuttle launch or NASA space activities. The risks for which indemnification is authorized are the risks of personal injury or death, or the loss of or damage to property or loss of use of property. These risks are described as unusually hazardous risks only in the sense that the potential liabilities could be in excess of the insurance coverage that a NASA prime contractor would reasonably be expected to purchase and maintain. The opinion takes pains to state that in no other sense may the activities of STS be considered as unusually hazardous. The authorization for indemnity is given only upon condition that the contractor maintain financial protection in a amount and kind approved by the Administrator. Each prime contractor must submit proof of such financial protection.

The opinion notes that the actual or potential cost, "if any" of the action authorized is impossible to estimate. "Such an occurrence may never occur; in the event of a major incident, millions of dollars of damage could occur."[290]

It has been reported that the appropriate indemnity clause has been included in about 40 contracts since the adoption of the Memorandum Decision.[291]

Answering questions on the nature and extent of injuries and damages covered by the NASA indemnity, and on the manner in which determinations would be made of the adequacy of private insurance, Neil Hosenball, General Counsel of NASA, responded:

> In the process of the submission of request by contractors, we have requested each of them to provide their insurance program to us and also to furnish us with the premiums that were paid in the prior renewal term. And, yes, it calls for a judgment. The example that I gave you earlier of one contractor who has indicated that his insurance in the prior renewal period was $234,000 related to the space shuttle, is now being increased to $3 million. We have to make a judgment as to whether there is a substantial risk of exposure, both from a legal as well as a technical standpoint. The contractors are concerned about a catastrophic situation, as well as from the point of view of potential lawsuits. Whether there would be recovery or not remains to be seen. For example, if a shuttle with three commercial payloads were on board, happened to land in a populated area, you would not only lose the three payloads but there would be damage on the ground, as well. If you just look at the payload situation itself, you could have upward of $200 million right there, just in the payload cost. On top of that, you would have loss of revenue and consequential damage claims, in addition to

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[290] NASA Memorandum, 39 Fed. Cont. Rep. 216 (BNA) (1983), __Fed. Reg. __(1983).

[291] Telephone conversation with James Pesnell, NASA Senior Procurement Officer, and David Sudduth, NASA, 5/21/87.

> which some of our commercial carriers have been selling off transponders. Those transponders could go for as much as $10 million, so the worth of that satellite could be, rather than $50 million, $200 and some-odd million dollars. So, you have a potential of lawsuits that could well exceed insurance limits. Now, we have made a judgment that the risk to the Government if the Government were to indemnify, is very, very small. That is a judgment we have to make -- both that the incident would occur, and second, that there would be the type of recovery I have indicated.
>
> However, contractors say:
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> > Well, that is fine for the Government to take that position. If the Government does suffer a loss, why, the Government would still continue. However, if we suffered the loss, we could very well be out of business.
>
> And so they have that concern. I think it is a legitimate concern for a business to take. It is for that reason that we have proceeded with the indemnification.[292]

Note that his response was given several years before the Challenger shuttle disaster.

It has been noted by industry commentators that the test established by NASA for the availability of indemnities essentially relies on the Administrator's discretion and judgement. NASA provides indemnities for "unusually hazardous" risk -- i.e. government indemnity above the level of insurance available to the contractor. The amount of insurance available, as the testimony of NASA's counsel showed, is not a fixed amount but depends on a judgement as to how much insurance is available to the contractor, which in turn may depend on insurer's judgement of the particular risks involved. Although NASA maintains that its measure -- unusually hazardous risk -- as defined by insurance availability is more accurate than the standard applied under the DOD's authority under Public Law No. 85-804, both standards actually require the exercise of Administrator's judgement. It is clear from the Memorandum Decision adopted by NASA that the definition of "unusually hazardous risk" defined as indemnity above the level of insurance available saves the agency reclassifying a project as hazardous, since it has taken the position that it is not engaged in any hazardous activity in its STS projects.

A limited indemnity program was provided by the Federal Aeronautics Administration (FAA), which undertaken in 1981 provided for contracts to reprogram the computers used by air traffic controllers, the FAA En Route Air Traffic Computer Replacement Program. The Memorandum Decision which includes the authorization for indemnities recognizes the potential for major liability arising out of aviation accidents, and also recognizes that the contract would not be undertaken unless indemnity were provided.[293] There was no special legislation to authorize indemnities for the particular project, but the Memorandum Decision includes a finding that the project to reprogram computers for civil aviation would advance national defense functions, and was therefore appropriately authorized under Public Law 85-804 and Executive Order 10789, and under the provisions for military research and development under 10 U.S.C. §2354.

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[292] Testimony of Neil S. Hosenball, General Counsel, NASA, before the Subcommittee on Administrative Practice and Procedure, Senate Judiciary Committee, 98th Cong., 1st Sess. On Oversight Hearing on Indemnification of Government Contractors at 6-17 (March 18, 1983).

Indemnification under the Federal Aviation Act of 1958 as amended, and the War Risk Insurance Provisions which preceeded the current Federal Aviation Act provisions, provide for indemnities, but as has been previously noted, the indemnification provision has found little application in the past few years, and the revolving fund which supplies the means for indemnities has not been used since the Vietnam War, and remains undiminished.[294]

The major indemnification scheme under the Price-Anderson Act[295] has been enhanced and reauthorized for the fourth time, but fortunately no indemnities of any kind have thus far been paid for the damages of an extraordinary nuclear incident. The one effort to use the Act to obtain indemnification for the costs of planned evacuation at the time of the Three Mile Island incident was turned down by the court as not covered by the Act.[296]

EPA is authorized by recent amendment of the Superfund law to indemnify response action contractors, (RACs) i.e. contractors that contract to undertake response and remedial clean-up activities under the Superfund law.[297] Although the law provides for indemnities, for such contractors, EPA has clearly distinguished RAC liabilities from private liabilities of generators, transporters and disposers of hazardous wastes, the PRPs, i.e. the potentially responsible parties.[298]

The Department of Health and Human Services is reported to have used indemnity provisions in earlier contracts involving clinical experiments on human subjects. Information from HHS officials indicates that no indemnification clauses have been in included in HHS contracts for the last several years.[299] There appears to be a general resistance to the inclusion of indemnity clauses in HHS contracts, which are viewed as affording a new opportunity for litigation directed at the government's deep pocket. To some extent this reaction appears to have resulted from, or have been strengthened by, the Department's Swine Flu litigation experience.[300]

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[293] 46 Fed. Reg. 62596, 62597 (1981).

[294] See text at N. 138 *supra*.

[295] See text at N. 57 *et seq.*, *supra*.

[296] See N. 84 *supra*.

[297] See text at N. 185 *supra*.

[298] 42 U.S.C.A. §9607.

[299] Telephone conversation with Jeffrey Robbin, attorney, General Counsel's Office HHS, 5/18/87 and 8/25/87.

In addition to indemnity clauses in contracts by authorized agencies, there have been instances in which agencies have gone ahead and granted indemnification without such authorization. The Office of Federal Procurement Policy (OFPP) in a statement relating to its activities concerning product liability and indemnification of government contractors, commented on the work of an Interagency Task Force on Indemnification which reported in 1982. It was made up of representatives of the Offices of General Counsel of DOD, DOE, DOJ, NASA, NRC, FEMA, MSF, GAO and Commerce along with OFPP representatives. It noted:

> Several agencies reported contracting situations under which they had agreed, without specific authority, to indemnify contractors engaged in certain activities. Those activities included contract airline evaluation flights from Southeast Asia (AID), acquisition of utility services for federal services for federal installations (GSA), and testing of devices and compounds using human subjects (HHS). In addition there were a few instances reported where contractors refused to compete for contracts without being indemnified. Representatives of the private sector reported their experience with increased liability insurance premiums; the infinite nature of their tort liability exposure under many long-term government programs (including space activities); the effect of the doctrine of strict liability which is being applied in varying degrees in state courts; and what they perceive as the unfairness of the government's immunity from suit in certain product liability situations.[301]

No evidence was found of the number of contracts involved in each of these situations, nor is there any available evidence of the amount of indemnification paid in these miscellaneous instances.

The Cost of Indemnification in Government Contracts

Indemnity clauses in government contracts place the U.S. at great risk of contingent liabilities. In the case of nuclear accidents, for instance, the contingent liability under current law is in excess of seven billion. The indications of contingent liabilities in NASA contracts are in the hundreds of millions, if not more. While the percentage of contracts involving the Department of Defense in which indemnities are included, constitute a vanishing percentage of the number of contracts entered into, there are nevertheless an average of about 75 contracts a year entered into by DOD in which indemnities are provided.[302] In the case of DOD contracts, the annual March 15 report to Congress required under the National Defense Contracts Act,[303] the evidence is clear that there have been no indemnity claims for the past 3 years and there is no evidence that there have been any others before then. While the reports for 1982, 1983, 1984, 1985, and 1986 each show "contingent liabilities" for each branch of the Department of Defense Armed Services, these contingencies are listed as cost-free, because none of them had occurred during the calendar year. The report notes each year that "the potential cost of the liabilities cannot be estimated since the liability to the Government, if any, will depend upon the occurrence of an incident as described in the indemnification clause." The summary table for the 1987 report indicates such contingent liabilities in 3 contracts of the Army, 33 contracts of the Navy, and 16 contracts for the Air Force.[304]

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[300] *Id.*

[301] *Statement of the Office of Federal Procurement Policy Concerning Product Liability Problems Encountered by Government Contractors*, Hearing before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, 98th Cong., 1st Sess. on Oversight Hearing on Indemnification of Government Contractors, at 4 (March 18, 1983).

The record of the past several years in DOD contracts is born out by the earlier experience reflected in the legislative history of the 1977 readoption of the National Defense Contracts Act. In supporting the readoption of the Act, the Congressional committee noted that no indemnity payments had been made in the period from the initial enactment of the law until its proposed readoption.[305]

The revolving fund under the Federal Aviation Act which earlier provided war risk insurance, appears to be intact because no indemnity payments have been made.

Other, smaller indemnity programs for FAA, HHS, and other agencies have been noted, but no evidence has been found that any indemnities have been paid upon the occurrence of a particular covered event. The only evidence of substantial government expenditures is in the case of the Swine Flu program, which was not an indemnity program at all, but a program in which the United States made itself a substitute defendant for the manufacturers and participants in the administration of the Swine Flu immunization.

There is virtually no evidence that the government has had to make good on any of its contingent liability under contractual indemnity provisions in the past 30 years or so, since the passage of the National Defense Contracts Act in 1958, and the Price-Anderson Act in 1957. Government agencies and departments may be reluctant to discuss indemnities, but even if this reluctance has led to an underestimation of contractual indemnities paid by the government, such an underestimation or possible partial reporting is possible only if indemnities paid were not very substantial.

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[302] See text at Ns. 282-283, supra.

[303] Public Law No. 85-804, 50 U.S.C. § 1431.

[304] 133 CONG. REG. H.1510 (March 23, 1987).

[305] As expressed by the Chairman, Committee on the Judiciary, House of Representatives by the Bureau of the Budget, United States Atomic Energy Commission, Department of Commerce, Comptroller General of the United States, and the Department of Interior, reprinted in 1958 U.S. Code Cong. & Ad. News 4050-4054.

The information here drawn upon does not include data on the recent space shuttle disaster. Consideration of the space shuttle disaster, and of the near disaster a few years ago at Three Mile Island indicates that in spite of the low cost of contractual indemnities thus far, the contingent liabilities assumed by the government are real, and may turn into pressing realities without advance notice.

The Impact of the Anti-Deficiency Act

The cost of indemnities in government contracts has long been a matter of some concern. For many years, until May 1982, indemnity clauses exposed the government to open ended liabilities. After May 3, 1982, following a decision by the General Accounting Office (GAO) indemnity clauses in government contracts must specify that the indemnity is available only to the extent of available authorization, pursuant to the Federal Anti-Deficiency Act.[306]

The Anti-Deficiency Act prohibits incurring of any obligation for the future payment of money in advance of or in excess of a appropriation adequate to cover it.[307] The Comptroller General, in a decision on May 3, 1982, held that a clause for use in cost reimbursement contracts entitled "Insurance-Liability to Third Persons," in the Federal Procurement Regulations (now replaced by FAR) violated the Anti-Deficiency Act.[308] The Decision had initially been made in response to a request from the Department of Health and Human Services (HHS) and the opinion notes that the clause "provides virtually complete indemnity to contractors for any liability incurred in the performance of such contracts, in unlimited amounts and without restrictions."[309] In its initial decision the Comptroller General suggested a modification of the clause to provide that the indemnity be limited to amounts available in agency appropriations at the time the liability arises, and that nothing in the contract be construed to bind the Congress to appropriate additional funds to cover any deficiency. The opinion was promptly challenged by the Public Contract Law Section (PCLS) of the American Bar Association, urging reconsideration. Although the Comptroller General generally does not render decisions in response to requests from non-governmental entities not parties to the dispute in question, in this instance, however, "We recognize that the PCLS reflects the views of many persons who do business with the government and who would be directly affected by our decision if all federal agencies implement it."[310] The Bar Association interveners asserted that the May 3, 1982 decision upset a 40-year practice based on a 1943 decision of the Comptroller General. It claimed the destabilizing effect of the opinion and asserted that there was no Anti-Deficiency Act violation and that the decision conflicted with earlier decisions by the Comptroller General. Following an elaborate process of distinguishing earlier cases and differentiating the 1943 opinion relied on for the 40-year practice, the Comptroller General concluded that its initial decision had been correct. The clause is clearly in violation, he held, because under it the maximum liability is not determinable and it is not possible to set aside sufficient funds to meet the obligation if and when it occurs.

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[306] 31 U.S.C. §1341.

[307] *Id*.

[308] B-201072, May 2, 1982. (unpublished)

[309] *Id*.

> Who can set a maximum price, at the time the indemnity obligation is incurred, on a human life or predict the amount of a court award for serious injury or other dire consequences arising from the performance of a contract? We find that the clause, on its face commits the Government to pay at some future time an indefinite sum of money should certain events happen. There is no possible way to know at the time the contract is signed whether there are sufficient funds in the appropriation to cover the liability if or when it arises because no one knows in advance how much the liability may be.[311]

In the reconsideration, the Comptroller General also invalidated the modification recommended by the GAO because in the Comptroller's view it is a "naked promise because an appropriation may be exhausted at the time a loss occurs." The Comptroller General observes that the effect of the indemnity may well vary under the proposed modification depending on whether the accident indemnified occurred at the beginning of the fiscal year, when appropriations were still available, or at the end of the fiscal year when few appropriations would be left over. The Comptroller General also notes that even if adequate funds are available, the need to meet the obligation of the indemnity may well exhaust a particular department's resources for the rest of the fiscal year, which would also be undesirable.

As the Comptroller General's opinion itself recognizes, the reach of the decision relating to the application of the Anti-Deficiency Act is not very broad. He refers to indemnity contracts "protected by the statutory umbrella," which includes contracts under the National Defense Contracts Act, Public Law 85-804 and other laws as to which Congress has made a statutory exception, in the exercise of its legislative powers. As noted earlier, expressly excepted legislation includes the Price-Anderson Act.[312]

In the course of Congressional hearings on proposed indemnity legislation, industry witnesses generally call attention to the restrictive impact of the Anti-Deficiency Act ruling, though it does not appear that the ruling has made any significant difference in the government contracts of the many agencies that include indemnity provisions in their contracts pursuant to the National Defense Contracts Act. Past experience with the extension of authority to grant indemnities to the FAA,[313] indicates that the National Defense Contracts Act, and the related Executive Order, are capable of some expanded interpretation, so that the impact of the Anti-Deficiency Act may not be as significant as some of the government contractors assert.

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[310] 62 Comp. Gen. 361, 362 (1983).

[311] Id.

[312] 42 U.S.C.A. §2210(j).

VI. CURRENT AGENCY VIEWS ON INDEMNITIES IN GOVERNMENT CONTRACTS

An effort to arrive at a shared agency approach to indemnification of government contractors is contained in the January 28, 1982 report of the OFPP Interagency Task Force on Indemnification, entitled "Indemnification of Government Contractors Against Third Party Liability Claims." The Task Force consisted of ten members, nine of them representatives of the Offices of General Counsel of executive agencies and departments, DOD, DOE, DOJ, NASA, NRC, FEMA, NSF, Commerce, a representative from the General Accounting Office, and representatives of OFPP. The report contains the caveat that it reflects the personal analysis and findings of each member, it does not necessarily reflect the view of their respective agencies. In spite of this caveat, there was a dissent from the report by the Department of Justice representative. The following is the summary of the Task Force conclusions:

> "1. There is a reasonable justification for amending E.O. 10789, as amended, to authorize all Executive Agencies who may exercise functions in connection with the national defense to agree to indemnify against third-party liability claims under the authority of Public Law 85-804 and subject to the other conditions in E.O. 10789, as amended.
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> 2. E.O. 10789 also should be amended to permit an eligible agency to agree to indemnify a contractor if the particular contract gives rise to the possibility of 'catastrophic losses' which should be defined as 'losses which the particular contractor cannot reasonably protect against through private insurance or self-insurance by the payment of a reasonable premium or the establishment of or reliance on a reasonable self-insurance reserve.'
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> 3. The head of an Executive Agency has the authority to broadly construe the clause appearing in paragraph 1 of E.O. 10789, as amended, which authorizes the agency to agree to indemnify a contractor whenever in his judgment 'the national defense will be facilitate thereby.'
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> 4. The Task Force is not now prepared to recommend that there is a convincing justification to provide through legislation for the indemnification of all Government contractors. Furthermore, the

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[313] See N. 293 supra.

> Task Force believes that if the Executive Order is amended as proposed, indemnification will be made available to most contractors who need the protection of indemnification. Some members of the Task Force believe that legislation should be drafted to reverse the precedent of Stencel Aero Engineering Corp. v. United States, 431 U.S. 666 (1977) and, moreover, to require the Government to indemnify a contractor where the contractor is held liable under the doctrine of strict liability as a result of Government imposed specifications or drawings. However, a majority of the Task Force believed that a recommendation proposing such a sweeping change in its United States law should be supported by an in-depth study. Moreover, such a study would no doubt duplicate the work underlying H.R. 1504, 97th Cong., 1st Sess. a bill 'to provide indemnity for suppliers of products to the Government in certain cases in which such suppliers become liable for loss with respect to those products, and for other purposes' and similar bills which the Congress has had under consideration recently. Finally, we believe such a study should be undertaken by a team representing the various interest affected and not solely representatives of Government agencies."[314]

The Task Force report points out that the Task Force was stimulated by the report in 1972 of the Commission on Government Procurement which had recommended that legislation be enacted to provide for government indemnification of contractors for liability damage arising from a catastrophic accident occurring in connection with a government program.[315] Such indemnification, it had been recommended, should be above the limit of available insurance.

In Congressional testimony, one of the co-chairman of the Task Force related that the Task Force had sent out a memorandum to 35 executive agencies, to inquire whether they felt a need to indemnify their contractors. Nineteen responses were received indicating that some agencies had been required to provide indemnities in order to accomplish their mission, even though these agencies did not have express statutory authority to indemnify. The Task Force could not point to any written record of evidence that potential contractors had refused to bid on a government contract because the agency refused to undertake to indemnify them. It was asserted, however, that there was some indirect evidence that this may have occurred in the past.[316]

The Task Force recommendations essentially amount to slight expansion of authority under Public Law 85-804 and Executive Order

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[314] OFPP Interagency Task Force on Indemnification, Indemnification of Government Contractors Against Third Party Liability Claims, at 2 (Jan. 28, 1982).

[315] Commission on Government Procurement, vol. 4 at 100 (1982).

[316] Hearings before the Subcommittee on Administrative Practice and Procedure, Senate Judiciary Committee, 98th Cong., 1st Sess. on Oversight Hearing on Indemnification of Government Contractors, at 21 (March 18, 1983).

10789. The Task Force would also expand coverage for catastrophic losses, but it did not recommend legislation to indemnify all government contractors. In spite of the very modest expansion of government indemnification recommended by the Task Force, the Department of Justice representative dissented, and it appears that the Justice Department's point of view reflects the view of the Reagan Administration. Testifying before a Congressional committee in opposition to H.R.1623 on Nov. 6, 1985, Richard Willard, Acting Assistant Attorney General, Civil Division, Department of Justice, indicated that the existence of indemnification would tend to subject the government to larger judgments because of the deep pocket aspects of the government's involvement. He also asserted in testimony that indemnification is not the way to deal with the tort law changes that have occurred in the area of strict product liability.[317] He has also taken the position that the government is not equipped to evaluate insurance needs involved in every contract which the government would have to determine given the provision for indemnification above the amount of reasonable insurance.[318] He asserted that the Justice Department prefers tort reform to indemnification, such tort reform to consist of limiting unreasonable awards and punitive and non- economic damages, such as damages for pain and suffering.

The tort reforms to which Assistant Attorney General Willard refers are incorporated in the so-called "Administration Liability Reform Package" introduced in the House of Representative on May 7, 1986, consisting of a proposed "Product Liability Reform Act of 1986," "Government Contractor Liability Reform Act of 1986," and the "Federal Tort Claims Reform Act of 1986." In the course of introducing this package of legislation, Representative Fish noted that the three-part legislative package is the out-growth of findings and recommendations made by the Administration's interagency Tort Policy Working Group chaired by Richard K. Willard, Assistant Attorney General, Civil Division, Department of Justice.[319] The tort law reforms to which Mr. Willard referred in his testimony, which are to be preferred to government contractor indemnification, were included in the report of the group which he chaired, namely the *Report of the Tort Policy Working Group on the Causes, Extent and Policy Implications of the Current Crisis in Insurance Availability and Affordability*, (U.S.

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[317] Testimony and prepared statement of Richard K. Willard before the Subcommittee on Administrative Law and Governmental Relations of the House Judiciary Committee, 96th Cong., 1st Sess. on H.R. 1623, at 21, 25 (Nov. 6, 1985). See also similar testimony in opposition to S. 1254, 96th Cong., 1st Sess., Hearings before the Senate Judiciary Committee, at 18, 21 (June 11, 1985).

[318] Testimony and Statement of Richard K. Willard, in opposition to H.R. 4083 and H.R. 4199, Hearings Before the Subcommittee on Administrative Law and Governmental Relations, House Committee on the Judiciary, 98th Cong. 2d Sess. at 44, 52 (March 14, 1984.)

[319] 132 CONG. REC. H2468-69 (May 7, 1986).

Department of Justice Task Force, February 1986.) The specific recommendations of the Tort Policy Working Group were to return to a fault-based standard of liability; to base causation findings on credible scientific and medical evidence; to eliminate joint and several liability in cases where defendants have not acted in concert; to limit non-economic damages, such as damages for pain and suffering, mental anguish or punitive damages to a maximum dollar amount; to provide for structured verdicts, i.e. for periodic instead of lump-sum payments of damages for future medical care and lost income; to reduce awards of damages by the amount of recoveries from collateral sources; and to limit attorneys' contingency fees to reasonable amounts on a sliding scale. The Administrations' general policy reflected in the Liability Reform Package was to improve insurance availability at reasonable premium rates, thereby deemphasizing the need for government indemnity of contracts.

The Justice Department has also taken the position that there is no major problem with existing rules of indemnification and with existing limits on indemnification because government contracts are being actively pursued.[320] Whether the absence of government indemnification and the presence of excessive risks discourages suppliers from bidding for government contracts is difficult to prove or disprove. The evidence is not overwhelming either way, but testifying before another Congressional committee, one industry representative asserted that he knew of at least one situation where his company, TRW,[321] backed out of competing on an FAA contract because of the lack of an indemnity clause, and a witness appearing for the American Bar Association noted that at least one major chemical manufacturer has dropped out of government contracting because of insurance unavailability.[322]

The Department of Defense has long taken the position that current indemnification authorization under the National Defense Contracts Act is adequate and that contractors should cover their own risks except for unusually hazardous or nuclear risks. As noted earlier, DOD has included indemnification clauses in some 50 to 80 contracts out its many million contracts each year. NASA has supported a moderate expansion of the use of indemnities in its contracts. In one of the Congressional committee hearings it was noted that NASA regulations authorizing indemnity clauses in its contracts have been issued because

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[320] Testimony of Asst. Atty. Gen. J. Paul McGrath, Hearing Before the Subcommittee on Administrative Practice and Procedure of the Committee on the Judiciary, U.S. Senate, 99th Cong., 1st Sess. on S. 1839, Contractor Liability and Indemnification Act (10/18/83) Part 3 at 7.

[321] Testimony of T. Richard Brown, Vice President, TRW for the Subcommittee on Administrative Law and Government Relations of the Committee on the Judiciary, 99th Cong., 1st Sess. on H.R. 1623 - The Fair Allocation of Government Fault Act, at 47 (11/6/85).

[322] Testimony of Ms. Karen H. Williams ABA, Id., at 73.

NASA was paying unreasonable premiums for liability insurance since contractors are reimbursed for the premium payments of part of the cost of the contract. NASA had indicated that the Agency would be unable to attract private contractors without such indemnity clauses. NASA noted that in negotiating renewals of existing coverage, premiums had very substantially increased.[323] One subcontractor working for both the Air Force and NASA continued working for the Air Force because it received indemnity coverage while discontinuing work for NASA due to lack of such coverage. Under the current NASA policy it is the responsibility of the shuttle contractors and subcontractors to ask NASA for indemnity coverage and approximately 10 contractors had done so from the start of the program until March 8, 1983. Not all contractors ask for coverage because some consider their insurance coverage adequate. NASA indicates that it is reluctant to label their projects as potentially involving catastrophic loss as under Public Law 85-804 but prefers to indemnify for unusually hazardous projects, which may involve loss above the level of reasonably available insurance coverage.[324]

NASA notes that the vast majority of all of its contracts are cost-plus contracts, and there is a direct pass through of premium insurance premium cost to the government. Contractors cannot apply for the inclusion of an indemnity clause in their contracts until after the contract has been awarded. Indemnification is not used as a consideration in awarding contract bids. NASA used to believe that its system is a reasonable one and has not presented any problems. It appears that by mid-1987, NASA had approved approximately 40 indemnification clauses in its contracts. There have been no request for indemnification pursuant to these agreements. Even the Challenger disaster has not resulted in any requests for indemnification up to this point.[325]

The policy of the Department of Health and Human Services (HHS) as currently maintained is not to include indemnity clauses in HHS contracts. HHS does not view the grant of authority as explicit.[326] In addition believes that indemnification clauses violate the Anti-Deficiency Act and that consequently HHS would only agree to indemnity clauses which specify a maximum dollar amount or where the time period of appropriation covered is defined. Furthermore, the experience under the Swine Flu Act has led to an attitude that government's deep pocket must be protected, and that if contractors or groups of contractors insist on special indemnity clauses they can "get them from the Hill," i.e. they can get special legislative authorizations. HHS would in most instances opt for special legislative approval.

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[323] See Comments of NASA Counsel Hosenball at N. 263 supra.

[324] Testimony of S. Neil Hosenball, NASA General Council, Hearings Before the Subcommittee on Administrative Law and Government Relations of the Committee on the Judiciary, 99th Cong., First Sess., on H.R.1623 - The Fair Allocation of Government Fault Act (11/6/85) at 6.

[325] Telephone conversations with James Pesnell, Senior Procurement officer, NASA and with David Sudduth, 5/21/87.

[326] See text at N. 54 supra.

None of the departments and agencies of the U.S. Government appear to feel any strong need for the expansion of indemnities in government contracts, nor for broad legislation that would extend indemnities to government contractors generally, across-the-board. Testimony before Congressional committees and telephone conversations with members of agencies and departments convey the impression that they are reasonably satisfied with the present state of the law and the present state of practice. In general, there is no feeling that current practices and limits on indemnities discourage potential contractors from bidding. In the few instances where increased insurance costs have changed the willingness of contractors to undertake risky tasks, as most notably in NASA with respect to the shuttle contracts, the movement in the direction of greater use of contractual indemnities has come as much from the government as from contractor pressure -- NASA seemed to have provided authority for indemnity clauses in its contracts when it appeared that rising insurance costs had an undesirable effect on cost reimbursement contracts.[327] Having accepted the use of indemnification clauses in its contracts, NASA has granted such clauses to some 10 contractors in 40 contracts. Having changed the regulations in this respect, NASA seems to be content to leave current law and regulations unchanged.

DOD, too, seems to find no reason for change in the law and regulations. There is no indications that DOD considers its practices in limiting the grant of indemnification clauses as a discouragement to potential bidders, and it is clear that DOD takes the position that if current law and regulations discourage bidders, it is up to industry to make that case.

The Department of Health and Human Services (HHS) also takes the position that, in the main, current authorizations for contractual indemnities are adequate. However, there is recent evidence that HHS's policy to turn down contractors' requests for indemnification clauses has adversely affected the mission of the National Institutes of Health in several areas. This has occurred in areas of AIDS research, in research on prophylactics in connection with AIDS, and in certain areas of contraceptive and carcinogen research. In the case of contraceptives, two research contracts have been terminated, because the contractors were unable to obtain liability insurance.[328] Another area where indemnity clauses have been sought from HHS is in asbestos removal. Contractors have asked for, but have not received indemnity clause contracts and since contractors cannot obtain adequate insurance protection, many smaller companies have gone into asbestos removal since they are more willing to risk bankruptcy at some later date.[329]

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[327] See text at N. 291 supra.

[328] See N. 54 supra.

While acknowledging that there are some emerging areas where indemnification may be required, HHS would prefer to leave that problem to legislative resolution, on a case-by-case basis, rather than by way of across-the-board indemnification laws or broader regulatory authority. If proposed research contracts involving clinical investigation using human subjects or clinical investigations relating to AIDS and its prevention, remedial measures, immunization or cure were to increase the pressures for contractual indemnification, HHS is likely to deflect these pressures to provide authority for specific indemnification but limited contractual undertakings to Congress.[330]

VII. FEDERAL INDEMNITY LEGISLATION PROPOSED

In the last eight years or so, a number of bills were introduced in Congress and hearings were held on a few of them. None of them, however, were reported out of committee, and there was no discussion of indemnity issues of any kind on the floor of the House or Senate.

Three types of bills were introduced and the bills within each type followed or duplicated each other very closely.

The first type of newly proposed indemnity legislation is an effort to codify and perhaps to expand slightly the government contract defense.[331] H.R. 5351, 96th Cong. 1st Sess., was entitled "Government Contractors' Product Liability Act of 1979" (September 20, 1979). It was intended,

> to establish just standards of ultimate liability for suppliers of products to the United States Government by providing indemnity for those suppliers in certain instances in which the United States Government is logically responsible for the harm creating the supplier's liability but cannot be required to provide indemnity because of sovereign immunity.[332]

The bill provided that the government shall be liable as indemnitor for any loss experienced by a contractor because of the "characteristic" of a product supplied to the United States Government if that characteristic was required by Government specifications. The purpose of the statute is rendered even more clearly apparent by the fact that on the same day, September 20, 1979, Congressman Gudger, who introduced the Government Contractors' Product Liability Act also introduced H.R. 5358, a bill for the relief of Stencel Aero Engineering Corporation.[333]

A more advanced version of the same approach to government indemnification of contractors is represented by H.R. 4083, 98th Cong., 1st Sess. (Oct. 5, 1983), "Government Contractors' Product Liability Act of 1983" introduced by Congressman Sam B. Hall Jr.

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[329] See N. 299 *supra*.

[330] See N. 281 *supra*.

[331] For discussion see text at N. 7, *supra*.

[332] H.R. 5351, 96th Cong. 1st Sess., (September 20, 1979).

[333] For discussion of the Stencel case, see N. 9 *et seq.*, *supra*.

The bill authorizes the indemnification of a contractor for product liability claims as well as for liabilities that were incurred by the contractor for damages resulting from harm caused or contributed to by the misuse or modification of a product by the U.S. Government.

No indemnity would be available if the liability arose solely on account of the negligence of the supplier, or if the supplier knew or should have known the defect in the characteristic of the product unless the supplier informed the Government of the defect and the Government required the characteristic to be retained pursuant to the contract after being informed of the defect; the product was designed or manufactured in accordance with commercial standards or is generally available to persons other than the Government; or the supplier either designed or participated in designing the specification pursuant to which the contract was performed.

Procedurally, the Act allows the contractor to bring an action for indemnification or to join the United States as a third party in any civil action brought against it for damages in a product liability claim. The bill also allows the U.S. to intervene in civil actions brought against a supplier for product liability, and provides that the right to indemnification under the Act shall be established by a preponderance of the evidence. The Act requires notification of the Attorney General of any product liability action brought against the supplier for which indemnification will be sought.

The bill establishes comparative responsibility as a basis for the determination of the amount of indemnification to be provided. It also establishes comparative responsibility in cases of misuse or modification of a product. The Act defines misuse or modification of a product to include the use of a product in disregard of warnings or instructions, or in a manner different from the reasonable practice of users of the product.

No indemnification is to be available for claims arising outside the U.S. or arising under admiralty or maritime jurisdiction of the U.S. The indemnification to be provided is to be reduced by any amount of insurance paid to the supplier on account of the losses indemnified. The Act is to apply with respect to claims for damages "arising after" the date of enactment.

Another approach to contractor indemnity legislation reflects an effort to assure a fair allocation of responsibilities between the Government and the contractor in cases that give rise to liability. H.R. 1623, 99th Cong., 1st Sess. (March 20, 1985) was introduced by Representative Kindness for himself and several other members of the House.

The bill provides for "equitable reduction of liability." When a civil action is brought by an officer or employee of the U.S. or by his legal representative, against a contractor for harm or injury for which such officer or employee is entitled to receive workers' compensation or other benefits from the U.S. pursuant to Title 10, Title 37 or Title 38 of the U.S. Code or under Chapter 81 of Title 8, the court, upon application of any party, is to make findings of fact as to the proportion that the fault of the U.S. bears to the total fault of all persons in causing the harm for which suit is brought. The amount the U.S. is entitled by law to be reimbursed through subrogation for benefits provided under the various compensation plans is to be reduced by the proportion of fault of the U.S. in causing the harm as found by the court. The contractor who wishes to claim the benefit of the section must give written notice to the Attorney General within 90 days after the filing of the civil action.

In determining the proportion of fault of the United States, the court must consider a number of factors relating to the contract specifications for which the U.S. is responsible, and to the degree of care exercised by the U.S. in the use, application and maintenance of products or services after delivery by the contractor.

The bill further provides that the U.S. shall hold harmless and indemnify any contractor against any liability arising out of or resulting from goods or services supplied pursuant to a contract, to the extent that such liability exceeds the amount against which the contractor is protected through commercial insurance or qualified selfinsurance which he is required to maintain in order to be entitled to the indemnity. The indemnity covers liability for all damages arising from personal injury, illness, or death from damage to or loss of use of property. The indemnification provided is not to apply to liabilities arising out of or resulting from the use of goods or services which are also sold by the contractor to non-governmental purchasers for uses substantially similar to the uses or applications of the goods and services by the United States.

The bill provides for rulemaking by the administrator of a federal procurement agency, after opportunity for a hearing, to provide guidelines relating to limitations affecting goods supplied to non-governmental purchasers for non-governmental uses, and relating to the amount of commercial insurance and qualified selfinsurance required.

Liabilities and risks for which indemnification is provided under the Price-Anderson Act are exempted from coverage. The bill also provides funding sources for the payment of indemnities.

The third type of recently proposed indemnity legislation is exemplified by S. 1839, 98th Cong., 1st Sess. (Oct. 18, 1983) introduced by Sen. Grassley. Similar to earlier mentioned bills that require apportionment of liability between the government and the contractor, this bill also requires the apportionment of workers' compensation benefits in cases of civil action brought by an employee of the United States against any contractor, where the employee has received workers' compensation benefits.

However, the bill requires the United States to include in any contract the provision that the United States will hold harmless and indemnify liability claims against the contractor. the required indemnification is to apply only to claims for losses or injuries resulting from risks that the contract has defined as: 1) unusually hazardous or nuclear in nature, or 2) giving rise to the possibility of liability against which the contractor cannot reasonably protect through private insurance or selfinsurance. No such provision shall be included in any contract for the procurement for goods and services which are sold by the contractor to a non-governmental purchaser for uses or applications identical in nature and scope to the uses of the goods and services by the United States. The determination of these conditions should first be made by the agency, i.e. by the head of the agency or his designee, and may require that each contractor so indemnified provide and maintain financial protection of the type and in such amount as the department head or his designee may determine.

Indemnities are to cover personal injuries and property loss or damage, and the costs of litigation and settlement insofar as not compensated by insurance or otherwise.

The proposal contains the usual provisions against indemnification for willful misconduct or lack of good faith on the part of the contractor and for notice to the United States of any claim or action, and for the control or assistance by the United States, at its election, in the litigation or settlement of the claim.

In 1984, Representative Kindness introduced H.R. 5883, 98th Cong., 2nd Sess, which in most respects and with few formal changes follows Sen. Grassley's 1983 bill. In 1985, Senator Grassley introduced the bill he had introduced in 1983 without changes, S. 1254, 99th Cong., 1st Sess. (June 30, 1985). Hearings on S.1254 were held on June 11, 1985 before the Senate Committee on the Judiciary. Witnesses from the Administration included Richard K. Willard, Acting Assistant Attorney General Civil, Division U.S. Department of Justice, and Mary Ann Gilleece, Deputy Undersecretary for Acquisition Management, Department of Defense. Their testimony reflected the Administration position that no new legislation was necessary, as has been earlier recounted.[334] Industry witnesses included Jeffrey J. Weinsten, President, Winfield Manufacturing Co. on behalf of the American Apparel Manufactures' Association; T. Richard Brown, Vice President, Law Department, Electronic and Defense Sector, TRW, Inc. and Fred Souk, Counsel; James J. Perino, Director, Insurance and Risk Management, Rockwell International Corp., on behalf of the Contractor Liability and Indemnification Alliance; and Robert C. Gusman, Chairman, Indemnification Project Group, Aerospace Industries Association. In addition there was testimony from Karen Hastie Williams, Chairman, Legislative Liaison Committee, Section of Public Contract Law, American Bar Association and O.S. Hiestand, Jr. Vice Chairman, Committee on Insurance and Indemnification, American Bar Association.

Industry witnesses fully supported the proposed legislation, reiterating their concern that the present state of the law frequently resulted in contractor liability for faulty government specification.

The purported problems created for industry by Stencel Aero Engineering Corp. v. U.S.[335] and Lockheed Aircraft Corp. v. U.S.[336] were repeatedly referred to. Another concern expressed was that of exposure to catastrophic loss. One of the comments was that the issue had been raised long ago, in the 1972 report of the Commission on

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[334] Text at N. 315 et seq., supra.

[335] 431 U.S. 666 (1977).

[336] 460 U.S. 190 (1983).

Government Procurement,[337] yet in spite of repeated support for the recommendation of a national policy to shield contractors from catastrophic liability, nothing had happened to bring this about.

The witnesses from the American Bar Association also supported S.1254, pointing to the long-standing support by ABA of federal legislation to alleviate the unique problem of government contractors who face extraordinary liabilities as a result of their government contract work. The witnesses from the American Bar Association also asserted that current statutory authority for indemnification does not work well. In particular, the point was made that the standards in current legislation, such as "unusually hazardous," are vague and difficult to apply, and that the decision to indemnify is largely discretionary. Agencies are under no requirement to explain why a request for indemnification is denied, and contracting officers who implement the law are not well versed in the concepts of indemnification, third party liability, casualty insurance and the business practices of the insurance industry. The application of current law is therefore frequently inconsistent and unpredictable, because it requires the parties to reach agreement on issues that are highly conjectural or speculative, including identification of risk, estimates of future costs and availability of insurance, as well as estimates on the utility of useful life of products not yet built.

The House also held hearings in 1985, on H.R. 1623. The array of government and industry witnesses and the positions they expressed was similar to that at the Senate hearings that year. However, there were also two "public interest" witnesses, Joseph Goffman, Staff Attorney for Public Citizens' Congress Watch, and Linda Lipsen, Legislative Regulatory Counsel, Consumers Union. Their position was that the "Fair Allocation of Government Fault Act" would relieve contractors of liability, would encourage contractor negligence by protecting them against the full reach of their responsibility. Acknowledging the need for indemnification in cases of major disasters where victim compensation may be necessary and in ultrahazardous activities where adequate insurance is unavailable, it was suggested that the agency's authority to indemnify contractors should be expanded to cover cases where the facts warrant -- i.e. on a contract-to-contract basis, rather than across-the-board by general indemnification legislation.[338]

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[337] See text at N. 315 *supra*.

[338] Hearing before the Subcommittee on Administrative Law and Governmental Relation of the House Committee on the Judiciary, 99th Cong., 1st Sess., (Nov. 6, 1985).

Hearings were also held in 1983 on S.1839,[339] and in 1984 on H.R.4083 and H.R. 4199.[340] In 1983, the Subcommittee on Administrative Practice and Procedure of the Senate Judiciary Committee also held an oversight hearing on the indemnification of government contractors.[341] The hearing records demonstrate that since 1983, the positions of the Administration, of major defense contractors, and of general public interest representatives have remained unchanged.

VIII. AVAILABLE CHOICES

It is the position of the current Administration that no further legislation authorizing contractual indemnities is necessary or called for. The no-action option has been the practical choice since the passage of the National Defense Contract Act in 1958. To call it a no-action choice may be somewhat misleading because it merely means that no action will be taken which tries to address the issue of government indemnification broadly, but that, responding to particular needs, legislation will be initiated to deal with them in a narrow and specific manner. This report provides instances of limited government authority for the grant of contractual indemnities when needed by specific agencies to secure contractors to undertake tasks which involved greater than ordinary risks. The no-action alternative has proven persuasive in the recent past, because there is very little evidence that the absence of indemnification has discouraged many potential bidders from undertaking government contract work. In the few instance where contractors could not be persuaded to take government work without indemnities -- such as in the case of NASA's space shuttle in the case of the public health service Swine Flu Program, or in the case of IBM's reluctance to reprogram the flight controllers' programs, -- appropriate, narrowly defined authority was provided to deal with a specific issue.

The no-action option may also be persuasive, because thus far it has been practically cost free. Although the Government under current authorizations for contractual indemnities has undertaken vast contingent liabilities, the Government has not thus far been held accountable to make good on any of the indemnities it has provided. While the government as a frequent deep pocket defendant in the courts pays out millions of dollars in non-contractual indemnities under the Federal Tort Claims Act and under other laws which provide an opportunity for the application of common law indemnities,[342] there is no record of government payments of indemnity obligations incurred contractually.

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[339] Hearing before the Subcommittee on Administrative Practice and Procedure of the Senate Committee on the Judiciary, 98th Cong., 1st Sess. on S. 1839, the Contractor Liability and Indemnification" (Oct. 18, 1983).

[340] Hearings before the Subcommittee on Administrative Law and Government Relations of the House Committee of the Judiciary, 98th Cong. 2nd Sess. on H.R. 4083 and H.R 4199 (March 14 and 15, 1984).

[341] Hearing before the Subcommittee on Administrative Practice of the Senate Committee on the Judiciary, 98th Cong., 1st Sess., Oversight Hearing on Indemnification of Government Contractors (March 18, 1983).

In the response to the insurance availability crisis, so-called, of the mid-80s which replicated the insurance availability crisis of the mid-70's,[343] there has been a major effort to undertake a program of "tort reform" in several states as well as through federal task forces and other programs. Tort reform in this instance means legal changes to limit the size of personal injury verdicts, to reduce or do away with damages for pain and suffering and for punitive damages, to limit joint and several liability, and to insist on the fault principle and on clearer evidence of causation, so as to reduce the number and size of plaintiffs' verdicts. The purpose of this effort is to make available liability insurance available at more affordable rates, which in turn, the Administration believes, will make insurance available to government contractors and will lessen the need for government indemnities.

The option of taking no legislative action yields, however, to some demands for change, as for instance in the recommendations of the OFPP, Interagency Task force on Indemnification, which though not recommending any legislative changes, saw "a reasonable justification" for amending Executive Order 10789 to authorize all executive agencies who may exercise national defense functions to agree to indemnify against third party liability.[344] What is, of course, always a possibility -- which has been used before as in the case of the FAA authorization to construe the National Defense Contract Act -- is to give it expanded meaning to meet the conditions for which indemnification may be granted, i.e. that the indemnification will "facilitate" ... the "national defense."[345]

Without expanding contractual indemnification substantively through new legislation, certain steps could be taken administratively to provide a better basis in the future for determining whether broader indemnification is called for. Current law and regulations do not contain any requirement that the Administration report to Congress or anyone else that it has paid out on any of its obligations to indemnify. Based on telephone conversations with attorneys in different agencies responsible for contractual indemnification,[346] and on indications contained in miscellaneous reports, as well as on examination of the last five years' printout of Lexis cases on indemnification, it is clear that the United States has not paid out on any of its indemnifications, and if it has done so, it has done so only occasionally and in relative modest amounts. It would be helpful to determine clearly and without any lingering doubt how often and in what amounts the government has been called on to make good on its contractual indemnifications. A simple reporting requirement by an agency like the General Accounting Office would provide the necessary information on a regular basis.

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[342] In 1982 the Government defended 10,561 tort suits seeking $154 billion in damages. Testimony of Mary Ann Gilleese, DOD, N. 255, supra.

[343] See, e.g. introductory comment on unavailability of insurance coverage by Rep. Glickman, Hearing before the Subcommittee on Administrative Law and Government Relations of the House Judiciary Committee, 99th Cong., 1st Sess. on H.R.1623, at 1-2 (Nov. 6, 1985).

[344] See text at N. 313 supra.

[345] See text at N. 292 supra.

Although government agencies believe that current law provides adequate guidance, in determining whether or not a particular government contractor ought to be granted an indemnity clause, contractors, and knowledgeable legal analysts have raised the issue of undue vagueness in such language as "extraordinary risk" "unusually hazardous," activities and similar terms that describe conditions under which indemnities may be granted. In some instances indemnities are available beyond the threshold of reasonably available private insurance. In other instances insurance availability, as in the case of NASA indemnities, the degree of risk may be defined in terms of insurance availability. NASA defines unusually hazardous risks as risks that give rise to potential liabilities in excess of the insurance coverage that a NASA prime contractor would reasonably be expected to purchase and maintain. The American Bar Association has asserted that determinations of risk and insurability are extremely difficult, and that contract offices are not always equipped to deal with them, and that, in consequence, decisions relating to indemnities involve great uncertainty and may be made quite inconsistently. Except in cases where procurement involves urgent necessities and short deadlines, the determination of issues of risk and insurance availability could be delegated to an agency or office that has the requisite expertise to make such decisions or to assist appropriate agencies in making such decision as the need for the award of indemnification clauses arises. The purpose here is not administrative over-elaboration, and it may well be inappropriate to provide for proceedings of any formality that may then in turn provide opportunities for further administrative, or even judicial review. The major purpose of such a development would merely be to provide the technical capability to make decisions which must be made quite routinely in granting government indemnification.

A further step in the development of contractual indemnities would move in the direction of limiting government indemnities to agencies involved in high risk activities, or to limit them, regardless of the agencies involved to high risk activities of a clearly defined nature. Current law has gone some distance in limiting government indemnities to certain agencies involved in activities carrying high risks. Agencies involved in defense contract work, as under the National Defense Contract Act, the activities engaged in by the department of Energy and the Nuclear Regulatory Commission as covered by the Price-Anderson amendments, and the activities of NASA in its space shuttle work, all meet the general description of high risk activities undertaken by agencies authorized to carry out such activities. In other situations, however, when agencies such as FAA or HHS or EPA, whose normal activities may not be regarded as involving special risks, become involved in high risk activities as a result of technological developments, they may need the power to grant indemnity clauses to government contractors in order to deal with newly emerging problems. In the past, agencies have had to seek special authority for this purpose, and this has either happened administratively, by the expansion of existing authority or the broad reading of past authority, or it has been done by special legislative authorization, as in the case of the assumption of the risk by the government in the case of the Swine Flu Program. Risk assessment, a highly technical task, is not within the capability of all administrative departments and agencies. DOE and NRC as well as EPA and the U.S. Public Health Services in HHS may have risk assessment problems and technical capability to resolve them as part of their ordinary tasks. Other agencies may not. It may be possible to look into agency capabilities and to determine whether risk assessment tasks in the context of contractor indemnification can be placed on them, or whether some other structures, possibly interagency structures, should be utilized to do what may need to be done with newly emerging technological risks in the government contract area.

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[346] Telephone conversations with William Coleman, OMB Office of Procurement Policy, 5/12/87 and 9/14/87; James Pesnell, NASA Senior Procurement Officer, 5/21/87; Jeffrey Levitky, attorney, DOJ, 8/26/87 and 9/14/87; Peter Brien, DOD Contracts Office, Cost, Price and Finance, 9/17/87; Jeffrey Robbins, attorney, HHS Office of the General Counsel, 5/18/87 and 8/25/87.

There clearly is a need to address the problem of mass injuries and major losses resulting from catastrophic accidents in government programs. The issue was first addressed in 1972 in the Report of the Commission on Government Procurement. For its example, the report referred to the Texas City disaster on April 16 and 17, 1947. The government, following World War II, decided to market ammonium nitrate as a fertilizer. Two ships carrying ammonium nitrate under a government contract exploded at the docks in Texas City. The Commission reports on the incident as follows:

> The explosion destroyed virtually the entire dock area of Texas City, killing some 570 persons and injuring 3,500. Approximately 1,000 homes, industrial plants, and other buildings either suffered major damage or were totally destroyed. The total claims were originally estimated at $200 million. After denying relief to the plaintiffs [in Dalehite v. the United States, 346 U.S. 15 (1953)] Congress enacted the Texas City Disaster Relief Act in 1955, eight years after the disaster. Under a 1959 amendment, it was estimated that an additional $4 million would be needed for payment although appraisals of the actual damages ranged from $300 million to billions of dollars. The army paid $17.1 million in settlement of claims on the limited settlement authority of the Relief Act, with the last payment being made in September 1962,

fifteen years after the disaster.[347]

Noting the inadequacy of private means to deal with such catastrophic accidents, the Commission summarized the available government indemnity authorizations, under Public Law 85-804, the Price-Anderson Act, and other indemnity authorizations, and concluded that both private means and existing statutory authority were generally inadequate to deal with disasters of the Texas City kind. Current legislation is not only inadequate to provide the means to cope with such a disaster, but, except for the Price-Anderson Act, does not contain procedural means to deal with the multiplicity of claims effectively and to deal promptly with the need to compensate and relieve mass injuries. The report made two relevant recommendations:

> Recommendation 4. Enact legislation to assure prompt and adequate compensation for victims of catastrophic accidents occurring in connection with Government programs.
>
> Recommendation 5. Enact legislation to provide Government indemnification, above the limit of available insurance, of contractors for liability for damage arising from a catastrophic accident occurring in connection with a Government program.[348]

The issue of victim compensation and the need for adequate government programs in this field have been addressed in a 1963 study by the Legislative Drafting Research Fund of Columbia University. It contained recommendations for interim emergency compensation and for ultimate compensation by way of direct actions against the government. An alternative indemnification remedy was also suggested.[349] A recent comment on the problem of compensation for catastrophic accidents noted that in spite of the awareness of the problem, there had been no government action of any kind since the Texas City disaster 40 years ago.[350]

Current law provides indemnities that are generally limited as to the nature of the risk to be indemnified, and while they have no express upper limit, except in the case of the Price-Anderson indemnification for extraordinary nuclear incidents, they all have, in effect, a co-insurance clause, because in general the indemnity does not apply until after the amount of available private liability insurance has been exhausted. An indemnity law of general applicability, unlimited as to the amount of coverage or the nature of the risk, would make the federal government the insurer for all government contractor activities. This is not a realistic choice for indemnity legislation. The broadest existing law is probably the indemnification provision under the Price-Anderson Act which is limited both as to amount and the nature of the risk covered by the indemnity. The other broad indemnity authorization, the National Defense Contracts Act, together with Executive Order 10789 provides broad authorizations which are non-specific with respect to the nature of the risks covered, but do in effect authorize agencies to impose a limit on the amount of indemnity to be provided.

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[347] Report on the Commission of Government Procurement, vol. 4 at 99-103 (1972).

[348] *Id*.

[349] Rosenthal, Korn and Lubman, CATASTROPHIC ACCIDENTS IN GOVERNMENT PROGRAMS (Legislative Drafting Research Fund of Columbia University, 1963, an independent study for the National Security Industrial Association).

[350] Dembling, *Catastrophic Accidents: Indemnification of Contractors Against Third Party Liability*, 10 J. L. 1 (1982).

There has never been a study of the cost of contractual indemnification. What this study shows is that although contractual indemnification involves administrative costs for the management of the grant of contractual indemnities, there have been hardly any costs in the payment of meeting indemnity obligations by the government, because there is no evidence of litigation to recover such indemnities, nor is there even any evidence of claims for such indemnities.

On the other hand, the government is a perpetual defendant in common law actions for indemnities for claims asserted under the Federal Tort Claims Act. There has been no analysis of the amount of such recoveries and of the character of the indemnity claims on which recoveries were based. Such a study could be used as a basis for the consideration of contractual indemnification in lieu of indemnification recovered by way of litigation under the Federal Tort Claims Act and other laws. It is possible that contractual indemnification of the many claims which are now made by way of tort litigation may be less expensive in terms of litigation costs than the current system which limits contractual indemnification but in which the government is held as indemnitor in many law suits.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-3

IMPLEMENTING THE BANK HOLDING COMPANY ACT: THE ADJUDICATORY PROCEDURES AND INFORMAL BARGAINING PROCESSES OF THE FEDERAL RESERVE BOARD

by

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I. Introduction

The Federal Reserve Board (FED) is one of the most powerful and independent federal agencies engaged in economic regulation today.[1] Much of its power derives from its ability to set U.S. monetary policy,[2] but it also has extensive regulatory authority as well. Indeed, it is one of the primary regulators of banks and banking policy in the U.S.[3]

While the FED has long been analyzed, criticized or praised for its substantive monetary and regulatory policies, few studies, if any, have focused on the FED as an administrative agency. The primary purpose of this report is to examine some of the administrative law aspects of the Federal Reserve Board. Specifically, this report will focus on some of the FED's adjudicatory responsibilities under the Bank Holding Company Act of 1956, as amended. It also will examine an aspect of the FED's more informal processes, namely its use of conditions and voluntary commitments. Though it is not the purpose of this report to analyze or evaluate the substance of the FED's policies under the Bank Holding Company Act, a full appreciation of these procedural issues will require at least a basic understanding of the substantive context within which they arise.[4]

To this end, Part I of this report will first examine the basic structure and responsibilities of the Federal Reserve System and, in particular, the Federal Reserve Board. In so doing, it very briefly will describe the structure and the independent nature of this agency.

Part II will then set forth the substantive background of the Bank Holding Company Act, its legislative predecessors and its amendments since passage in 1956. This section will highlight the regulatory evolution of this act and, in particular, the rapidly changing, increasingly deregulated financial services environment in which Bank Holding Companies (BHC's) must now compete. Indeed, there appear to be a whole new group of "non-BHC" BHC's moving into what many have long thought was primarily commercial banking territory.

New types of financial institutions have been competing head on with commercial banks in a wide range of product and geographic markets. Competition such as this has created a good deal of regulatory turmoil as well as pressure on the FED to relax controls on BHC's so that they can compete more effectively. These competitive pressures for change increasingly are reflected in both the substantive and procedural demands made on the FED. To understand the importance of the procedural demands made by some parties as well as the appropriateness of the agency's response, it is necessary to understand what is substantively at stake.

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[1] See, Thibaut De Saint Phalle, The Federal Reserve, pp.76-78 (1980).

[2] See Id., at 87-88.

[3] Id., at 7-9, 142-168.

[4] See Parts I and II, *infra*.

Part III of this report then examines aspects of the FED's adjudicatory procedures. Specifically, it focuses on when adjudicatory hearings are appropriate in Bank Holding Company Act proceedings. It examines the FED's implementation of the statutory hearing requirements set forth in Section 3 and Section 4 of the BHCA.

Part IV of this report then examines some of the issues that arise from the FED's use of regulatory conditions and, especially, voluntary commitments in implementing the regulatory requirements of the BHCA. Part IV is the heart of this report and its focus is on the kind of bargaining relationship that exists between applicants under the BHCA and the Federal Reserve Board. Part V then sets forth some tentative, draft recommendations dealing with the issues raised in Parts III and IV.

PART I

The Structure and Powers of the Federal Reserve System

The purpose of Part I is very briefly to set forth the basic structure and powers of the Federal Reserve Board. An examination of this background and structure is relevant because it raises three significant and very broad sets of questions whose answers may have procedural consequences. We shall first set forth these questions and then examine the powers and structure of the Federal Reserve System in more detail.

The FED has two very important and arguably distinct responsibilities. It is responsible for setting the monetary policy of this country and it also has significant and direct regulatory control over banks and certain aspects of banking policy. Its broad and extensive monetary powers and responsibilities have grown over time, particularly since our economy has become more global in nature. To what extent, if any, does the manner in which monetary policy is formulated influence the FED's procedural approaches when it comes to performing its regulatory responsibilities? Put more broadly, is the "ethos" of the FED largely established by its monetary responsibilities and, if so, does that "ethos" inappropriately affect its regulatory functions? In short, are these two areas of responsibility connected in any way and does that affect the FED's procedural responses on the regulatory side?

A second observation that a review of this background information provides is that Congress has not played a particularly active role when it comes to resolving important policy issues. As world conditions change, thereby affecting the monetary side of the FED's responsibilities and the structure of banking changes thereby affecting its regulatory duties, there has seemed to be little interest, willingness or perhaps ability on the part of Congress to make the necessary comprehensive legislative changes these new conditions require. There has been statutory tinkering, to be sure, but little statutory reform that realistically takes into account the true nature of a global economy. To what extent has Congressional inaction placed perhaps unrealistic demands on the FED to devise policies appropriate for the times, yet true to its statutory mandate? Are these kinds of pressure for change reflected - for good or for ill - in some of the procedural decisions made by the Board?

A third observation directly related to the structural description of the Federal Reserve System that follows is that this structure is, as one commentator has noted, "bizarre" and without "parallel among central banks abroad or among other domestic agencies."[5] To complicate matters even further, the jurisdictional overlap among the various federal governmental agencies that regulate banks and banking policy also may be described as somewhat "bizarre." There are at least seven regulatory agencies in the United States that have some control over depository institutions. These are: (1) The Federal Reserve Board; (2) The Comptroller of the Currency; (3) The Federal Deposit Insurance Corporation (FDIC); (4) The Federal Home Loan Bank Board (FHLBB); (5) The Federal Savings and Loan Insurance Corporation (FSLIC); (6) The National Credit Union Administration (NCUA); and (7) The National Credit Union Share Insurance Fund (NCUSIF).

This regulatory hodgepodge is rendered even more complicated by the fact that almost all banks in the United States are subject to regulation by some governmental authority and there appears to be little other than historic justification as to which entity this shall be. As Melton notes:

> State-chartered banks that are not members of the Federal Reserve System are regulated by their states' banking commissions. The Fed itself, however, supervises state-chartered banks that are members of the Fed. (In addition, the Fed regulates bank holding companies.) Nationally chartered banks are regulated by the Comptroller of the Currency. Similarly, thrift institutions with state charters are supervised on the state level, while those with national charters are subject to the Federal Home Loan Bank Board. Money market mutual funds, which provide services similar in some respects to bank deposits, are regulated by the Securities and Exchange Commission. U.S. branches of foreign banks fit into this scheme depending on whether they are state-chartered (and supervised by state banking commissions) or nationally chartered (and supervised by the Comptroller of the Currency). In addition, to ensure uniformity of regulation, the Federal Reserve has residual supervisory authority over all U.S. operations of foreign banks.[6]

It is not the purpose of this report to reform or untangle the multiple political compromises that have, over time, contributed to the crazy quilt structure and regulatory landscape within which the FED operates. Nevertheless, since our focus will be on the FED, particularly as it performs its duties in relation to the Bank Holding Company Act, it is important to understand the structural and regulatory complexity within which the FED operates. It is towards this end that we now turn to a description of the powers and structure of the Federal Reserve System.

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[5] William C. Melton, Inside the FED: Making Monetary Policy, Chapter 2, p. 4 (1985).

[6] Melton, supra note 5, at p. 6.

A. The Federal Reserve System

The Federal Reserve System was established on December 23, 1913, with the passage of the Federal Reserve Act. It consists of three components: the Board of Governors, the Federal Reserve banks and the member banks. We shall first briefly describe the evolution of its substantive powers and then examine its structure in some detail.

The reserve system initially was designed to remedy perceived defects in U.S. monetary policy and banking organization. Preceding its passage, there had been recurrent money panics and bank failures. Particularly notable was the panic of 1907 which, in many ways, was perhaps most responsible for the creation of the Federal Reserve System.[7]

As expressed in the Act's preamble, the original purposes of the Federal Reserve System were to give the country an elastic currency, to provide facilities for discounting commercial paper, and to improve the supervision of banking.[8] From the outset, the new Reserve System was conceived as a means of promoting economic stability through regulation of credit conditions.
Outlined in the Act was the skeletal framework for achieving these stated objectives. In order to provide a sound and elastic currency supply, the reserves of member commercial banks in the twelve newly created Federal Reserve Bank districts were centralized.[9] Member banks had access to reserves through discount and borrowing facilities.[10] Additionally, if a bank held sufficient assets to be eligible for discount with a Reserve bank, it was able to convert such deposits into Federal Reserve

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[7] Thibaut De Saint Phalle, The Federal Reserve, (Praeger Press, 1984). For a detailed description of this rush on the market see pages 46-49.

[8] Ibid. 2.

[9] Ibid. 2.

[10] Ibid.

currency under §16 of the Act. Power was delegated to the Federal Reserve Board to issue currency without limit.[11]

Facilities for discounting commercial paper were created by empowering the Reserve banks to discount standardized types of commercial paper and to deal in certain types of securities.[12] Finally, through creation of the twelve Federal Reserve Banks and of the Federal Reserve Board, composed of seven members including the Secretary of the Treasury and the Comptroller of the Currency, a supervisory body with the authority to oversee the volume, availability and cost of credit was established.[13] While the FED's responsibility for monetary policy is now foremost in everyone's mind, it is important to note that this was not one of the purposes envisioned in the original Federal Reserve Act. The act created the FED "as a collection of super correspondent banks organized chiefly to improve the country's payments mechanism and to provide for seasonal currency needs, while supporting the soundness of banking through its role as lender of last resort."[14]

The two principal functions of the Federal Reserve today, if not examined closely, seem remarkably similar to those undertaken by the original Federal Reserve. First, the Federal Reserve Board, in conjunction with several other agencies,[15] regulates the commercial banking system of the United States. Second, using its powers under §16 of the Reserve Act to determine the U.S. money supply, the Federal Reserve acts essentially as an independent Central Bank for the U.S. Government. Despite the apparent coherence between the original directives of the Preamble to the 1913 Act[16] and those duties today, the actual role that the modern Federal Reserve Board has assumed is now much more extensive.

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[11] *Ibid*. p. 264 (§16).

[12] *Ibid*. p. 265 (§14).

[13] *Id*.

[14] Melton, *supra* note 5, at p. 4.

[15] Most notably these are: the Comptroller of the Currency, under the National Bank Act of 1953, the Federal Home Loan Bank Board (FHLBB) under the Federal Home Loan Bank Act of 1932 which supervises thrifts and the Federal Deposit Insurance Corporation under the National Bank Act of 1933 (Glass-Steagall).

[16] The Preamble to the 1913 Act states: To provide for the establishment of the Federal Reserve Banks, to furnish an elastic currency, to afford means of rediscounting commercial

The commercial banking system which the Fed now regulates differs radically from the pay-on-demand account system, based on the gold standard familiar to the Reserve Act's creators. Little is mentioned in the Act about the establishment of a national monetary and credit policy conducive to maintaining economic stability.[17] Rather, the Act focused more on establishing service functions.[18] In today's economy, however, the introduction of wide scale credit based networks, NOW accounts, and other transactional forms of credit present the Federal Reserve Board with a very different and constantly evolving financial services industry.

More importantly, the role of the Federal Reserve as the central bank for the U.S. is now more significant than ever before. Control of the money supply has made the Fed the monetary policy planner for the United States. The fact that the entire global economy has been operating on a paper dollar monetary system since 1971 means that the Federal Reserve Board has enormous influence over the economic growth and functioning of not only the U.S., but the global economy as well. As one commentator points out: actions of the Board "determine whether the global economy functions in an inflationary or deflationary cycle; whether economic growth is encouraged or constrained; and whether, and to what extent spending or saving is stimulated or discouraged through greater or lesser growth in the U.S. money system."[19]

Another important aspect of the Federal Reserve's control of U.S. monetary policy is the relation of this control to government spending. When the Federal Reserve Act was passed in 1913, the public debt was very small. No one could accurately have predicted either its monumental increase in size or the use

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paper, to establish a more effective supervision of banking in the United States, and for other purposes.

[17] The Act did provide for such powers as discounting and changes in the discount rates, open market operations and examinations of member banks. These were, however, secondary considerations designed to promote sound credit conditions. See De Saint Phalle, the Federal Reserve, pp. 55-6.

[18] De Saint Phalle, supra note 7, at p. 55.

[19] De Saint Phalle, supra note, 7 at p. 10.

of the system's resources to finance this deficit.[20] The deficit and the impact interest rates can have on financing that debt is yet another aspect of the FED's enormous power.

In short, there can be little dispute that the FED's power and influence is now enormous. Characterizing the changes that have occurred since the Federal Reserve System was established in 1913, Thibaut De Saint Pnalle concludes:[21]

> It is no longer a mechanism mandated to make the banking system function better through new tools but rather a most powerful quasi-independent agency of government subject to no control or even audit.

B. The Structure of the Federal Reserve System

The Federal Reserve Board of Governors sits at the apex of the Federal Reserve System. Beneath it are twelve regional Federal Reserve Banks and a number of so-called member banks. Member banks are the financial institutions that own stock in their local Federal Reserve banks, thereby becoming members of the Federal Reserve System. National Banks - i.e. banks chartered by the federal government - must become members of the Federal Reserve System; state chartered commercial banks or trust companies, however, are not required to join.[22]

The Federal Reserve Banks were established by Congress to carry out the day-to-day operations of the Federal Reserve System. Subject to control by the Board of Governors, they operate the discount window through which member banks can borrow from the Federal Reserve bank in their district. They also carry out other open-market operations such as the purchase and sale of government securities, thereby increasing or decreasing the funds available for banks to lend. They also issue Federal Reserve notes, collect, clear, and transfer funds, handle U.S. Government debt and cash balances and, in effect, serve as principal fiscal agents for the U.S. government.

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[20] New York Commerce Clearing House Association, the Federal Reserve Re-examined (the New York Clearing House Association, 1953) p.3.

[21] De Saint Phalle, supra note 7, at p. 56.

[22] It should be noted that since passage of the 1980 Depository Institutions Deregulation and Monetary Control Act, however, non-member banks have access to some of the same services as member banks, including borrowing privileges. They also are subject to the same reserve requirements.

Congress divided the country into 12 Federal Reserve Districts, each of which has one principal bank. These banks were legally constituted as privately owned with special charters. There were also to be 25 branches of those banks to serve particular areas within each district. Congress was able to solve quite a few political problems with this structural device. Indeed, its purposes in establishing these regional branches were threefold: to ensure that all parts of the United States would have access to the Federal Reserve; to offer regional representation of required economic developments and needs in monetary policy; and to allow private individuals to participate in the banking system. As H. Parker Willis, one of the chief draftsmen of the 1913 Act remarked:

> The new act provides for twelve reserve banks,introduces the principle of local control, calls for strict government oversight, shifts reserves from present correspondent banks to new institutions, minimizes the influence of the larger banks in the directorates, and generally diffuses control instead of centralizing it.[23]

With the onset of the depression, however, it was clear that more centralization of monetary policy was necessary. The 1935 Banking Act thus vested more centralized authority over monetary policy in an entity called the Federal Open Market Committee (FOMC). The FOMC is composed of all seven members of the Board of Governors as well as five of the regional bank presidents. Of these five, the New York Fed's president is a permanent member, but the other eleven banks fill the other four places on a rotating basis.

The establishment of the FOMC deprived the regional banks of virtually all of their independent power to make policy. It did not, however, change their legal structure. They remain privately owned, have boards of directors and continue to pay dividends to their shareholding member banks. But all that remained of the authority of their boards of directors was essentially symbolic authority. They possess no authority whatever to determine the availability of reserves to the banking system.[24]

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[23] Cited in Melton, supra note 5, p. 8 (The Federal Reserve: A Study of Banking Systems in the U.S. (1915, p. 68).

In summary, the responsibility of the Board is, simply put, twofold: it guides the nation's monetary policy and it regulates banks. There are over 15,000 banks in the United States. Those chartered by the federal government are national banks; others are chartered by the states. While the FED exercises exclusive jurisdiction over monetary policy, its regulatory authority over these 15,000 banks is shared with various agencies, in particular the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the state bank superintendents. Its regulatory responsibilities are indeed extensive. As one commentator notes:

> In its regulatory role, the Board exercises functions related to both the Federal Reserve banks and the member banks. With respect to the Federal Reserve banks, the Board can examine these institutions, require reports from them, set the discount rates they allow their borrowing members, and regulate their check-clearing operations. It also has complete supervision over relations between a Federal Reserve Bank and any foreign bank. In regard to member banks the Board examines them and receives periodic reports (although the Comptroller of the Currency has the prime

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[24] The constitutionality of the Federal Open Market Committee was recently upheld in Melcher v. Federal Open Market Committee, 644 F. Supp. 510 (D.D.C. 1986). Senator John Melcher brought suit complaining that the five Reserve Bank Members of the FOMC were selected in violation of the Appointments Clause, Article II, §2, Cl. 2 of the Constitution.

The Appointments Clause requires that officers of the United States be appointed by the President of the United States with the advice and consent of the Senate. The court held that the Reserve Bank Members were not officers of the United States. The court further held that Congress could delegate to private individuals some of its Article I, §8 powers (coinage of money and regulating its value). Among the reasons for the court's decision is that Congress did not give the decisive vote about monetary policy to private persons. Seven of the thirteen members of the FOMC are appointed by the President with the advice and consent of the Senate. Melcher, at 523 n.26.

Courts have shown extreme reluctance to decide the issue in this case. Two prior cases, Riegle v. FOMC, 656, F.2d. 873 (D.C. Cir. 1981) and Committee for Monetary Reform v. Board of Governors, No. 83-1730 (D.C.C. Oct. 26, 1983) aff'd, 766 F.2d 538 (D.C. Cir. 1985), contained the identical issue. Both were dismissed because of lack of standing.

> responsibility for the examination of national banks, as opposed to state member banks where the prime responsibility for examinations rests with the Federal Reserve Board). Under the Depository Institutions Deregulation and Monetary Control Act of 1980, the Federal Reserve Board is authorized to require nonmember depository institutions, including savings and loan associations, savings banks and credit unions, to supply reports to the Board on their assets and liabilities. The Board also has considerable regulatory powers through its administration of the Bank Holding Company Act.[25]

This extensive regulatory authority is exercised largely on an independent basis by the Board. The seven members of the Board are appointed by the President, with advice and consent of the Senate, for fourteen year terms.[26] These terms are staggered so that one member's term expires every two years, thus limiting the number of appointments that a President can make in a single term. Members are removable by the President only for cause.[27]

More significantly, the Board is not dependent upon congressional appropriations for its operating funds. Pursuant to statutory authority,[28] the Board has the power to levy an assessment against Federal Reserve Banks to meet its operating expenses and it has complete discretion as to how these funds will be spent. Since they are not considered "appropriated funds,"[29] they are not part of the Budget and thus not subject to congressional review. The Board's finances are largely self-monitored by in-house procedures and audits by respected private firms. Another indication of its independence is the fact that the Board is not required to obtain advance approval from the OMB or any other officer or agency of the U.S. prior to testifying before Congress or submitting legislative proposals to Congress.[30] In short, the FED is remarkably free of direct political control.

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[25] De Saint Phalle, supra note 7, at p. 4. See Part II infra for Bank Holding Company Act discussions.

[26] 12 U.S.C. §241.

[27] 12 U.S.C. §242. Of course, the Chairman of the Board exercises tremendous power and, on a daily basis, seems much more responsible for Board policy than the individual members. Since the chairman's term is only four years, he or she is likely to be a bit more vulnerable to a presidential pressure.

[28] 12 U.S.C. §243.

[29] 12 U.S.C. §244.

There are some checks, however. The FED is subject to the APA and the Government in the Sunshine Act, and many of its decisions are subject to congressional oversight and judicial review. It must submit twice-annual reports on the state of the economy and the course of monetary policy as well as an annual report on the Board's operations to Congress.[31] Similarly, the Chairman and Governors also frequently speak before congressional committees on subjects such as the condition of the banking systems, pending banking and economic legislation, and budgetary and other economic matters. Hearing results, statistical reports and other information are usually summarized in the monthly Federal Reserve Bulletin.

Courts review the FED's regulatory actions, but play virtually no role in reviewing monetary policy; the Board's decisions in this area are, essentially, judicially unreviewable. Its activities are too discretionary for courts to deal with in any significant way. Moreover, as we shall see, the informality of the applications/negotiation process coupled with the need on the part of the applicants for a prompt decision often undercuts any significant oversight role that a court might play when it comes to the Board's regulatory responsibilities. There usually is every incentive on the part of the parties to reach an agreement that is mutually acceptable to the applicant and the agency. This highlights the need for proper procedures at the Board level, because significant review or correction is not likely to occur very frequently at the judicial level.

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[30] 12 U.S.C. §250.

[31] See 12 U.S.C. §225a (mandating twice-annual reports to Congress by the Board regarding its policies and objectives).

PART II

The Bank Holding Company Act

Parts III and IV of this report will focus on some of the important procedural questions that arise in the context of the FED's implementation of the Bank Holding Act. The purpose of Part II is to set forth the substantive context within which these procedural issues arise. As with the structural concerns discussed in Part I, an overview and some general observations regarding the Bank Holding Company Act will be provided first. Then we shall examine this Act in more detail.

A. An Overview

Perhaps the Board's most important regulatory role is implementation of the Bank Holding Company Act. The Act has two fundamental purposes. First, it is intended to preserve competition within the banking industry. It therefore attempts to prevent bank holding companies from spreading so rapidly as to undermine effective competition among banks in local and regional markets. Second, the Act is based on the premise that there should be a separation between "the business of banking" and commerce. Thus, the Board has exclusive jurisdiction to determine the extent to which BHC's can engage in so-called non-bank activities. To ensure stability in banking, the Act assumes that there are some risks that are not appropriate for banks to take. Nor should there be easy access to bank funds by companies engaged in pursuits unrelated to banking. Not only is such access risky, but it may provide for an inappropriate competitive market edge.

Such rationales and conceptions of what the business of banking is or should be about are now very much under fire. Changes in data processing and communications technology have created an essentially new financial services industry. "These new methods have revolutionized the business, and created new businesses and new products. Money market funds, central asset accounts, and universal life policies would have been impossible before data processing and communications technologies."[32] Some of the new services these new technologies have made possible raise new questions regarding just what "the business of banking," in fact, is. Is a line of credit provided by one's local Safeway supermarket a form of "banking?" Is Safeway a bank? New products and new services have, in effect, created new financial services holding companies which are not subject to the Board's jurisdiction, but nonetheless are very competitive with commercial banks and BHC's which are under the FED's control. This fact alone has put enormous pressure on the FED to broaden - through the bank holding company concept - the scope of activities that BHC's can engage in so that they can compete effectively with these essentially new financial service holding companies.

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[32] Sellers, Technology and the Future of the Financial Services Industry, 7 Technology and Society, p. 21 (1985).

As we shall see, in examining the historical account of the evolution of BHC's and their regulation, this is not necessarily a new story. Market pressures have always pushed BHC's in new directions and the flexibility provided by the bank holding company concept usually has allowed the kind of regulatory innovation necessary to meet new market demands. But along with the ability of the holding company device to achieve substantial product and geographic diversification, there has always been a regulatory price. Product and geographic expansion could not undermine competition, nor could it jeopardize the safety of the depositor by allowing banks or BHC's to go too far afield when it came to "the business of banking."

These "regulatory goals" or, depending on your perspective, these "regulatory barriers" to competition are now subject to intense scrutiny. One line of argument is that new data processing and communications technologies have created such a new and different financial services industry that the statutory goals expressed in the BHC Act and its amendments are irrelevant in at least two senses. First, changes in technologies have allowed new activities that the old acts simply do not cover. Thus, even if you agree with their basic goals - protection of competition and the need to ensure bank safety - these goals are not being applied to the new industry and the new entities that now exist. Second, even if these rationales are applied, they are steeped in New Deal conceptions and fears as well as a conception of an industry that no longer exists.

The McFadden Act of 1927, for example, was passed to prohibit interstate branch banking. National banks under the McFadden Act are not allowed to establish branches across state lines. But, as Wallace Sellars has aptly noted:

> ... major money center banks have offices in nearly every state. These take the form of loan production offices, mortgage processing and service centers, and related activities. Although they may not take deposits, they perform a variety of other banking functions. In addition, every major bank is a sponsor of one or more credit cards. Since credit cards are

> not limited by state boundaries, the McFadden Act restrictions become more irrelevant with every passing day. We may not have interstate branching, but we certainly have interstate banking.[33]

Similarly, the Bank Holding Company Act's requirements that non-bank activities of BHC's be closely related to the business of banking was being sidestepped by what we have called "non-BHC, BHC's," i.e. financial institutions as well as financial subsidiaries of non-financial firms that are able to compete with BHC's without Board restrictions. This was particularly the case before passage of the Competitive Equality Banking Act of 1987.[34]

This kind of process and the ability of market forces and new technology to render statutes irrelevant or obsolete is surely at the heart of many of the issues presented to the Board and it certainly, implicitly or explicitly, is at the heart of many of the calls for comprehensive congressional reform in this area. As one commentator notes:

> It is my opinion that the BHC as we have known it for more than a half century is in its twilight years. The era of the financial holding company (FHC) is now upon us. The BHC should quite naturally evolve into the FHC of the future. But what should and will occur may be two different things. Unless it is recognized that banks are in the financing business, and they are given the authority to meet their competitors over the broad range of financing activity on an equal basis, a list of leading FHC's of the 1990's will carry few familiar names from the domestic BHC's of the 1980's.[35]

There is, as this quote suggests, a second sense of irrelevance - i.e. regulatory purposes that are not only easily sidestepped and thus functionally irrelevant, but also regulatory purposes that even when applied speak to concerns that are no longer at the heart of the new industry that has evolved. As another commentator recently has written:

> The aim of Congress has been to protect depositors; practices that took place in the 1920's and that indeed call for serious attempts to bring such practices to an end precipitated its involvement. However, some 60 years later, it is time to reexamine, in the light of

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[33] Sellars, supra note 32, at p. 4.

[34] P.L. 100-86.

[35] Fischer, infra note 31, at p. 288.

> today's financial environment, the manner and the extent that depositors are entitled to special protection.[36]

The purpose of the sections that follow is to give us some sense of the evolutionary development of Bank Holding Company regulation. In so doing it may help us understand more fully the current context in which the FED must operate. Our purpose is not to suggest specific substantive reforms either from Congress or the agency. Rather, it is to show that the reasonably familiar procedural issues which are raised in Part III arise within a very charged, highly politicized context in which nothing less than the shape and structure of a new industry is at stake. With Congressional resolution of many of these issues highly unlikely, the focus of attention increasingly is on the Federal Reserve Board. In order to deepen our understanding of what kinds of substantive and procedural demands are now being made on this agency, it is useful to examine the evolution of the law that was developed and designed to deal largely with a very different financial services industry from the one that seems to be emerging today.

B. **The Years Prior to Federal (Bank Holding Company) Regulation**

As one commentator has aptly warned, "one of the first lessons learned in doing research relating to bank holding companies is that these firms have surprisingly little in common with each other apart from their Bank Holding Company (BHC) designation."[37] Before exploring the intricacies of this legal form, it is useful to note a number of other related organizational forms that preceded the bank holding company approach, and to set forth the basic regulatory givens that seemed to underlie both state and federal attempts to regulate these new legal entities.

The first basic point about banking regulation is that banking is subject to entry restrictions. Express authority is required from either a state or the federal government before any entity can enter into the business of banking. If approval is obtained from the federal government - i.e. the Comptroller of the Currency - it is a national bank. If it is obtained from the

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[36] De Saint Phalle, The Federal Reserve, p. 9 (Praeger, 1984).

[37] G. Fischer, The Modern Bank Holding Company: Development, Regulation and Performance p.4, (Temple University School of Business and Management, 1986). [hereinafter cited as Fischer].

state, it is a state bank. The resulting state or national bank will thereafter be supervised by the chartering authority - its primary regulator.[38] Banks can, however, convert from one type of charter to the other if they obtain the permission of the new regulator. This enables the dual system of state and federal regulation that develops to, in a way, check any excesses of regulation that might develop.[39]
The regulated entities can always try to find a regulator they may find more conducive to their needs.

A second basic point is that banking entry restrictions of various forms were developed for two fundamental reasons: (1) to protect depositors - banks are, above all, the custodians of "other people's money;" and (2) to limit competition - a highly competitive industry is thought to be characterized by a rate of withdrawals and failures of companies not able to compete that is unacceptable for the kind of safety and stability needed to have a banking system in which consumers have confidence.[40] It is concerns such as these that resulted in various attempts to control the competitive urge on the part of banks to set up branch banks, or to engage in what was called chain or group banking.

Branch banking involves only one bank, but more than one banking office. In contrast to branching, there also can be chains or groups of banks. Chains or groups of banks include at least two affiliated but separately chartered banks. Thus, in states that allowed branching, members of chains or group systems could be either single office or multiple office institutions. During the first third of the nineteenth century, branch banking flourished in the U.S. But, as Professor Fischer points out, "there is considerable evidence that individuals have served as officers and/or have hold controlling interests in two or more banks in the U.S. for nearly 150 years."[41] Indeed, branch banks themselves closely resembled bank holding companies. As Professors Jessee and Seelig have also noted:

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[38] Ginsburg, Interstate Banking, 9 Hofstra L. Rev. 1133, 1139 (1981).

[39] Id. at 1141.

[40] Id. at 1142.

[41] M. Jessee and S. Seelig, Bank Holding Companies and the Public Interest, p.7 (Lexington Books, 1977). [hereinafter cited as Jessee and Seelig].

> ...branches of the First Bank of the United States not only had their own directors and presidents but also functioned autonomously. Several large state banks also had many of the characteristics of holding companies. However, as a result of the Civil War and the National Bank Act, few branch banks remained in operation after the 1860's. Unit banks almost completely dominated the American banking structure as the twentieth century began.[42]

Branching was prohibited for national banks and largely restricted in many states for state banks as well. It was thus difficult for banks to serve rural areas and pressures began to grow to invent new ways to reach these new markets. Some states began to liberalize their branching restrictions, and the Federal Government soon followed suit. It passed the McFadden Act in 1927, thereby authorizing national banks to open a limited number of branches in their home communities.[43]

Another even earlier response to the limitations imposed on branching was multi-unit banking. It became increasingly common in the 1880's and usually took the form of chain banking; that is, one individual with common ownership in two or more separate banks. The entities thus were not branches, but they were not really unrelated, unit banks either. With few exceptions, before 1900 these chains were limited to but a few banks. But at the turn of the century, multiple-unit chain banking really began to take off and as Fischer points out, the process by which they came into being remains very relevant today: "although over 70 years have passed since these systems were organized, the reasons for their formation are not without parallels in the 1980's."[44] Quoting from an issue of the Journal of Business, published around the turn of the century, he notes:

> The growth of population and increasing congestion of traffic made for rapid development of banking in the outlying districts. The downtown banks could hardly but look with envy at the lucrative savings bank business that thus developed. With branch banking prohibited, the only solution was to buy into

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[42] Id. at p.4.

[43] Act of Feb. 25, 1927, ch. 191, §7, 44 Stat. 1224.

[44] Fischer, supra note 37, at p. 7.

established banks in the new territory or to establish new ones.[45]

There were many who doubted the wisdom of this approach. Largely relying on the traditional reasons for applying entry restrictions in the first place, they stressed the sanctity of the unit bank concept. They were not unsuccessful. Some states passed laws disallowing ownership of bank stock by corporations, but most states simply prohibited the purchase of shares of a state bank's stock by another state-chartered bank. Federal law was silent on this issue and since a holding company itself was not considered a bank per se, BHC's fell outside most existing regulatory schemes.[46] Beginning around 1920, holding companies became the primary vehicle by which state branch banking restrictions were circumvented because a single BHC with ten unit banks could easily substitute for a single bank with nine branches.[47]

BHC's were thus similar to chain banks in concept, but they also differed in crucial ways. They were not controlled by individuals or small groups of investors, but tended to be "corporate giants holding great financial power. The corporations' stockholders were widely dispersed, their management professional, and they typically included at least one metropolitan bank. Two characteristics thus set them apart from chain groups: a metropolitan lead bank and a form of centralized management."[48]

There were, in short, a variety of reasons why this organizational form took off to the extent it did in the 1920's.[49] Fischer notes four, in particular: (1) the need for rural bank expansion and reform; (2) the general merger movement of the 1920's; (3) the fear on the part of some banks that they would lose their correspondent business to expanding holding companies if they did not form their own bank-holding companies; and (4) the bull market of the 1920's. In addition, there was a fifth reason: bankers used the BHC to avoid branching restrictions, but since they anticipated much more liberal branching laws, they wanted to be well-positioned for the new market they envisioned. They thus sought to acquire the banks that they believed would ultimately become branches.

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[45] Id. at p. 8.

[46] Jessee and Seelig, supra note 42, at p. 6.

[47] Ginsburg, supra note 38, at p. 1156.

[48] Id.

[49] Indeed, Jessee and Seelig note that "groups controlled 2,103 banks at year-end 1929. These banks constituted 8 percent of the nation's total number of banks and operated more than 12 percent of all banking offices." Id. at 6.

These factors led to essentially the uncontrolled growth of bank holding companies during the 1920's. This growth did not go unnoticed, nor did it fail to concern some observers. The Federal Reserve Board's annual report of 1927 stated:

> Bank holding companies have been organized in increasing numbers to operate extensively in the field of banking, not simply as investment agencies, but specifically in individual instances to acquire control of corporately independent banking institutions through stock ownership and to exercise this centralized control in effecting bank mergers; in extending individual or virtually single corporate control over companies operating as subsidiaries in special fields of banking and in building up chain systems embracing in individual instances banking institutions operating under national and state charters in several states.[50]

These concerns were quickly dwarfed by the stock market crash of 1929. As the Depression spread, public attention became focused less on the growth of bank holding companies per se, and more on the non-banking acquisitions of those companies. Congressional investigations into stock market loans made by various types of banks prior to the 1929 collapse concluded that these activities played a significant part in the kinds of speculation that led to the 1929 crash. Four bills designed to limit holding company actions were introduced in 1930, but none was passed. Indeed, it would not be until 1956 that a federal legislative coalition could be established to pass the Bank Holding Company Act.

An important precursor of this Act, however, was the Banking Act of 1933--the Glass-Steagall Act. It contained a few sections pertaining to group banking. Though they did not have much impact, they nevertheless represented the first federal attempt to regulate bank holding companies. These provisions were, in large part, a partial response to the kinds of fundamental concerns that had always formed the regulatory justification for requiring entry restrictions in the first place. At the hearings that preceded this Act, many participants raised the threat for the continued existence of small banks that these large banking groups presented. Similarly, the substantial potential for conflicts of interest that might arise when a bank holding company controls non-banking interests was also noted.[51] Indeed, Congressman Letts asked Chairman Young of the Federal Reserve Board the following probing questions:

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[50] 1927 Federal Reserve Board Annual Report, quoted in Jessee and Seelig, supra note 42, at p.7.

> I have noticed a tendency on the part of banking institutions to go into many lines of business -- the handling of securities; the handling of mortgage business; agencies for the sale of real estate -- to the point that I understand the Transamerica Corporation has announced that it has the necessary funds to put over any enterprise that they wish to take hold of ... Is there a danger that a policy of this kind will lead to the point where financial institutions will serve themselves and their affiliates and not the public? ... In other words, will they compel men in business as individuals or in a corporate capacity, to play hand in hand with the financial groups, in order to get necessary accommodations? My concern is in regard to the powers that may be acquired through the policies of holding companies that sit back of the screen and control the activities of the banking institutions in a community and many other lines of industry. It is conceivable it may even go to the point of involving the control of companies that are engaged in the distribution of our foods and other necessities of life.[52]

The Act did not very effectively deal with these concerns. It did, however, require holding companies to meet certain conditions before they could obtain a permit to vote in the selection of directors of affiliated banks. These conditions required the holding company to agree to: (1) an examination by federal examiners of the holding company's subsidiary banks; (2) complete divorcement from the investment business within five years from the date of its application; (3) applicants also were required to hold a cert in percentage of marketable assets other than bank stock; and (4) they had to submit financial reports and declare dividends only out of actual net earnings.[53]

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[51] Hearings on Branch, Chain and Group Banks Before the House Committee on Banking and currency, 71st Cong., 2d. Sess. (1930), p. 17.

[52] Id. at 479. quoted in R. Natter, Legal Antecedents to the Bank Holding Company Act, Congressional Research Service Paper, p. 3 (1986).

The Act proved inadequate when it came to bank holding companies. BHC's were covered only if they controlled at least one Federal Reserve member bank. The Act could thus be avoided if the bank subsidiaries were all nonmember institutions. Moreover, the Act did not affect the ability of BHC's to expand or acquire additional nonbanking interests. Thus, Glass-Steagall did not require any consideration at all of the effect on competition that bank holding company expansion might have.

The limited reach of this Act did not seem to matter very much during the 1930's. This was a period of retrenchment as far as BHCs were concerned. Bank failures reduced existing BHCs and there was little economic incentive to form new ones. Moreover, the federal government was increasingly hostile to these organizational forms and the future of multiple-unit banking was in serious doubt. At one point, President Roosevelt sought essentially to eliminate all holding companies. Bills to that effect were introduced. Even the Federal Reserve Board of Governors began to play a much more active regulatory role vis-a-vis the holding companies that then existed. In 1948, the Board initiated proceedings under the antitrust laws against Transamerica Corporation, the largest BHC then in existence. Though the Board ultimately lost its case, attention was focused on the economic concentration represented by this bank holding company and the apparent difficulty of controlling companies like it under the law then in existence.

In 1949, however, economic incentives again sparked new interest in BHC's. As Professor Fischer has pointed out:

> Although there was negligible expansion in group banking from 1933 to 1948, considerable growth of these systems occurred from 1948 through 1956....Just as in the 1920's, there was an increasing amount of merger activity in other fields and a very good market for the shares of leading financial institutions. The movement of population and industry again raised problems for banks. This time, however, it had been mainly the city bank which found that it was losing its customers to the suburban institution. While the primary causes of the earlier expansion of group banking were the speculative mood of the 1920's and the extremely poor condition of many rural banks, the fundamental element in the growth of group banking in the early 1950's was

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[53] Jessee and Seelig, p. 8.

> the threat of federal legislation. It was feared that regulations would severely affect the merger activity of bank holding companies.[54]

The threat of federal legislation existed for many reasons. First of all, concerns were expressed concerning the soundness and safety of group banking as a whole and the problems of regulatory coordination that ultimately arose. As early as 1929, Comptroller John Pole noted before the House Banking and Currency Committee:

> Where a group is composed of both state and national banks, as well as of other types of financial institutions, it becomes practically impossible for any supervising governmental official to ascertain authoritatively and accurately the financial condition of the group as a whole. Each corporation in the group is an independent legal entity, some responsible to both state and national governments, and this creates a situation in which the public is not sufficiently protected, insofar as it can be protected by governmental authority.[55]

He proposed consolidation of control in one regulatory body.

In addition to lack of effective control, legislation proposed by the Roosevelt administration focused on the "great economic power" wielded by holding companies. In a special message to Congress in 1938, Roosevelt stated:

> It is hardly necessary to point out the great economic power that might be wielded by a group which may succeed in acquiring domination over banking resources in any considerable area of the country. That power becomes particularly dangerous when it is exercised from a distance and notably so when effective control is maintained without the responsibilities of complete ownership.
>
> We have seen the multiplied evils which have arisen from the holding company system in the case of public utilities, where a small minority ownership has been able to dominate a far-flung system.

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[54] Fischer, supra note 37, at p. 138.

[55] Id. at p. 139.

> We do not want those evils repeated in the banking field, and we should take steps now to see that they are not.
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> * * *
>
> I recommend that the Congress enact at this session legislation that will effectively control the operation of bank holding companies; prevent holding companies from acquiring control of any more banks, directly or indirectly; prevent banks controlled by holding companies from establishing any more branches; and make it illegal for a holding company, or any corporation or enterprise in which it is financially interested, to borrow from or sell securities to a bank in which it holds stock. I recommend that this bank legislation make provision for the gradual separation of banks from holding company control or ownership.[56]

This theme was echoed by the Federal Reserve Board itself. In hearings before the Senate Banking Committee, Marriner Eccles, then Chairman of the Federal Reserve, similarly explained the need for legislation:

> Accepted rules of law confine the business of banks to banking and prohibit them from engaging in extraneous businesses such as owning and operating industrial and manufacturing concerns. It is axiomatic that the leader and the borrower should not be dominated or controlled by the same management. In one exceptional situation, however, the corporate device has been used to gather under one management many different and varied enterprises wholly unrelated to the conduct of a banking business.
>
> * * *
>
> The problem of how far bank holding company systems should be permitted to expand has long been of serious concern. There is perhaps a greater need for a positive declaration of congressional policy on this question than on any other phase of the holding company problems. It is in this area that one of the greatest potential evils of bank holding company operations, that evil, which permits a holding company...to dominate major portions of the banking facilities of

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[56] S. Doc. No. 173, 75th Cong., 2d Sess. (1938).

> particular sections, is one which strikes at the heart of our traditional system of competitive banking.[57]

He went on to discuss the Transamerica Corporation, noting its size and power--41 banks, 619 banking offices in California, Arizona, Oregon and Washington. In addition, this corporation controlled various non-banking companies engaged in such activities as life, fire, automobile, and marine insurance, fish canning and processing, frozen foods, castings, forging, diesel engines, food processing, machinery, power control equipment, kitchen tools, color cameras, and agricultural equipment.[58]

When Congress failed to act, the Board, as we noted earlier, brought its own action under section 7 of the Clayton Act against Transamerica Corp. The failure of this suit also helped stir the legislative fires. In 1956, these various legislative threats and the political coalitions that were forming finally came to fruition. The legislative result was the Bank Holding Company Act of 1956.

C. The Bank Holding Company Act of 1956 (BHCA).

(1) A Statutory Roadmap. Thus far we have discussed primarily two federal acts that dealt, either tangentially or directly, with BHC's. The McFadden Act of 1927, as we have seen, authorized national banks to establish branches of their banks and the 1933 National Bank Act dealt directly, if ineffectively, with BHC's. We shall now examine the 1956 BHC Act and its amendments. This Act was amended in 1966 and, most significantly, in 1970. We shall discuss all "three Acts" - the 1956 Act, the 1966 amendments and the 1970 amendments. In addition, for clarity's sake, it should be noted that section 3(d) of the 1956 Act is often called the Douglas Amendment. That provision was incorporated into the original Act during the Senate debate[59] and it prohibited interstate acquisitions of banks by BHC's, unless these acquisitions were specifically authorized by the statutes of the state in which the bank is located. Finally, we briefly set forth the key provisions of the Competitive Equality Banking Act of 1987.

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[57] Providing for Control and Regulation of Bank Holding Companies, Hearings of S.829, Sen. Comm. on Banking and Currency, 80th Cong. 1st Sess., pp. 15-17 (1947).

[58] Id. at. 24.32. See Natter, Legal Antecedents To The Bank Holding Company Act, Congressional Research Service paper, at. p. 9 (June 4, 1986), setting forth this background in detail.

[59] 102 Cong. Rec. 5902, 6856 d(Apr. 24, 1956).

(2) The Legislation. The concerns set forth in Part A over the adverse effects of BHC's were reiterated in the hearings held on the bills that ultimately became the BHCA of 1956. For example, in the hearings in the House, William McChesney Martin, then Chairman of the FED, repeated the Board's long-time concerns:

> In the first place, there is nothing in present law which restricts the ability of a bank holding company to add to the number of its controlled banks. Consequently, there can well be situations in which a large part of the commercial banking facilities in a large area of the country may be concentrated under the management and control of a single corporation.
>
> In the second place, there is nothing in existing law which prevents the combination under the same control, through the holding company device, of both banking and non-banking enterprises. Obviously, this makes it possible for the credit facilities of a controlled bank to be used for the benefit of the non-banking enterprise controlled by the holding company. Moreover, the ordinary non-banking business requires a managerial attitude and involves business risks of a kind entirely different from those involved in the banking business. Banks operate largely on depositors' funds. These funds should be used by banks to finance business enterprises within the limitations imposed by the banking laws and should not be used directly or indirectly for the purpose of engaging in other businesses which are not subject to the safeguards imposed by the banking laws.

The House report issued with the Bank Holding Company Act picked up on some of these themes and emphasized others as well. It noted that the holding company movement threatened the existence of independent community banks, could result in monopolistic control of credit and enable banks to sidestep branching restrictions on both state and federal levels. Moreover, the holding company's non-banking businesses could occupy a preferred position in obtaining credit and lead to loans to affiliated companies that might not be appropriate under traditional banking standards.[60]

Similar concerns were expressed on the Senate side. Chairman Martin, for example, noted:

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[60] H.R. Rep. No. 609, 84th Cong. 1st Sess. 2 (1955).

> Mr. Martin...I believe the potential abuse in this field is the combination of banking and non-banking interests. You could not prove the extent to which there will be a danger. I am not trying to take the holding company device and say it is no good, but I can see quite a good deal of use for a bank holding company as to banks, but when you start mixing it and putting it into the area of possibly empire building, then I think you mix two functions that can lead to a great deal of trouble.
>
> Senator Douglas. The possibility of abuse depends almost in a direct ratio to the degree of control the holding company has over bank facilities. If there are adequate alternative sources of credit you cannot coerce people into using it, but if there are not alternative sources of credit then you can use your control of credit to get control over manufacturing, too.
>
> Mr. Martin. That is right.
>
> Senator Douglas. So that you do go back to the other field of the bank holding companies, namely, that they may get too large a share of control of credit within many localities.
>
> Mr. Robertson. That is true....[61]

Despite these concerns, the bill that ultimately passed was by no means a radical one. It did not view holding companies as "evil," nor did it try to abolish them. The BHCA of 1956 sought to control them.

Section 2(a) of the Act defined a bank holding company as "...any company (1) which directly or indirectly owns, controls, or holds with power to vote, 25 per centrum or more of the voting shares of each of two or more banks or of a company that is or becomes a bank holding company, or (2) which controls in any manner the election of a majority of the directors of each of two or more banks...".[62] By limiting application of the bank to two or more banks the Act continued to exempt one-bank holding companies from Federal regulation. At the time the Act was passed, one-bank holding companies were primarily small, closely held, family corporations or simply small banks held by nonbanking corporations.[63] Specific exemptions from coverage were also given for religious, charitable and educational organizations as well as certain investment companies.

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[61] Control of Bank Holding Companies, Hearings on S. 880 Before the Senate Comm. on Banking and Currency, 84th Cong. 1st Sess. 65-66 (1955).

[62] 12 U.S.C. §1841(a) (1964).

The Act requires that all BHC's, as defined by this Act, to register with the Board of Governors. Section 3(a) requires Board approval before acquiring more than 5 percent of the voting shares of any bank. Board permission is also required for the formation of a new holding company, for the acquisition by a company (other than a bank) of all or substantially all of the assets of a bank, and for the merger of any two bank holding companies.[64] In reviewing the applications of companies covered by the Act, the statute requires the Board to consider the following factors:

1) The financial history and condition of each company or bank.

2) The financial prospects of each.

3) The character of the management of each.

4) The convenience, needs, and welfare of the geographic area.

5) Whether the effect of the acquisition would be to expand the size of the BHC beyond limits consistent with adequate and sound banking, public interest, and preservation of competition in the banking field.[65]

Section 3(d), the so-called Douglas amendment, prohibits multi-unit expansion across state lines, unless state law itself authorizes such expansion. Section 4 of the Act requires BHC's to divest themselves within two years of non-banking affiliates and to refrain from any future acquisition of such enterprises.[66]

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[63] See Staff of the House Comm. on Banking and Currency, 91st Cong., 1st Sess., Report on the Growth of Unregistered Bank Holding Companies 6 (Comm. Print 1969).

[64] 12 U.S.C. §1841(a) et seq. (1964).

[65] 12 U.S.C. §1842(a).

[66] 12 U.S.C. §1843(a).

Exempted from divestiture were companies whose activities were all in the financial, fiduciary or insurance areas and which the Board determined to be "so closely related to the business of banking or of managing or of controlling banks as to be a proper incident thereto."[67] In addition, "cross-stream" lending by holding company affiliates was specifically prohibited in Section 6(a).

These provisions were designed to carry out the basic purposes of the Act, to wit:

1) the maintenance of the separation of banking and commerce;

2) the preservation of competition in banking markets;

3) the preservation of undue concentration of economic power; and

4) the protection of the right of states to determine the type of banking structure within their borders.[68]

As Professors Jessee and Seelig have noted, this Act was, like most pieces of legislation, a compromise. It satisfied neither those who feared the power of bank holding companies nor those who opposed any regulation at all:

> Some felt the legislation was a victory for group banks. But most bankers were not so optimistic. Some provisions, such as the prohibition of interstate banking, were clearly primitive. Others hindered normal credit and investment operations. Compliance would entail much... expense. And the wide discretionary power vested in the Federal Reserve Board would raise a great deal of dispute and many problems for all parties involved.[69]

In the Federal Reserve Board's first report to Congress two years after passage of the Act, and in each of its Annual Reports thereafter, the Board urged Congress "to subject a holding company to the 1956 Act if it owned 25 percent or more of the stock of a single bank; and (2) to include not only corporations and business trusts, but also long-term trusts as well as firms previously exempted, and operated for religious, educational or charitable purposes."[70] Except for the inclusion of the ownership of one bank in the definition of a holding company, these changes finally were adopted in 1966.[71] In addition, Section 3(c) was made much more specific concerning competitive effects and Section 6 was repealed. Pressure, however, continued to build for the inclusion of one-bank holding companies within the purview of the Act.

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[67] 12 U.S.C. §1843(c) (6).

[68] See Jessee and Seelig, supra note 29, p. 11.

[69] Id. at p. 11.

In reporting to Congress on the administration of the Act, the Board continued to urge that Congress extend coverage of the Act to one-bank companies. Because of this exemption, there was a significant increase both in the number of one-bank holding companies and the diversity of the activities that they pursued.[72] As Raymond Natter has pointed out:

> In the period from 1955 through 1968 ... the number of one-bank holding companies ... grew from 117 to 783. ... Further, between 1967 and 1969, 34 of the 100 largest commercial banks formed or announced plans to form one-bank holding companies, including 9 of the 12 largest banks in the country. Even more alarming, was the fact that these largely unregulated entities were engaging in a wide variety of commercial activities, ranging from agricultural, mining and petroleum operations to various types of manufacturing activities, as well as ... businesses in transportation, real estate and wholesale and retail fields.[73]

One-bank holding companies grew for the same reasons BHC's were developed in the first place. They allowed market forces to sidestep regulatory forces. Indeed, changes in technology and market dynamics greatly encouraged the growth of one-bank holding companies. Competition for savings from other types of financial institutions and customer demands for services such as credit cards, record keeping and computer services all combined to provide strong incentives for expansion.[74] As one commentator observed: "Throughout the 1960's, competition for savings from other types of financial institutions had grown so intense, and technological development had so changed the nature of banking, that the generic holding company was a logical outgrowth of failure to include the one-bank holding company under the 1956 Act."[75]

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[70] Id. at p. 12.

[71] See 1966 Amendments to Act, 80 Stat. 236 (1966).

[72] See Comment, Bank Holding Company Act, 39 Geo. Wash. L. Rev. 1209 (1970-71).

[73] Natter, Formation and Powers of National Banking Associations - A Legal Primer, Committee Print 98-4, p. 5-17 (May 1983).

The significance of these latter factors was reflected in the position taken by opponents of the 1970 amendments to the 1956 Act. Proponents of the amendments had argued that unregulated one-bank BHC's threatened to destroy the wall traditionally perceived as separating commerce and banking. Opponents, however, contended that it was the responsive and pro-competitive nature of the BHC form outside the regulatory frame that had enabled the banking industry to survive the challenges of the 1960's.[76]

The 1970 Amendments that were finally passed nevertheless included several important changes. The primary impetus for passing the amendment was to bring one-bank holding companies under control. The 1970 Amendments made that change.[77] Additionally important, however, were (1) the expansion of the test for defining "control" of a company so as to include more indirect forms of control; (2) the modification of the definition of "bank" to include any institution organized under the laws of the United States or any state that accepts deposits that the depositor has a legal right to withdraw on demand and engages in the business of making commercial loans;[78] (3) the change in wording of the directives pertaining to permissible non-banking activities; and (4) the introduction of a public welfare balancing standard for assessing the value of the related non-banking activities.

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[74] Comment, supra note 72, at 1209, n. 14.

[75] Id. at 1209.

[76] Edwards, The One Bank Holding Company Conglomerate, 72 Vand. L. Rev. 1275 1292(1969). ("The likelihood of achieving economies is much greater when banks are joined with other financial institutions, since the economic interrelationships among the products of banks and financial institutions are much greater.")

[77] Since "company" remained the operating word in the statute, not all loopholes were closed. While the 1956 provision exempting partnerships from the definition of 'company' was eliminated in (Act of Dec. 31, 1970, Pub. L. No 91-607 & 101 (b)(3), 84 Stat. 1762), individual ownership was not addressed. This proved to be particularly significant in chain-banking situations where one person controls a string of banks. The need to close this loophole was a principle motivator for the 1978 passage of the Change in Bank Control Act. Pub. Law No. 95-630 §602.

The expanded test for control in the Act gave the Federal Reserve Board authority to determine that a company was a bank holding company even in cases where the applicant had control of less than 25 percent of an affiliate's stock.[79] The impetus for this change stemmed from Congress' recognition that the complexities inherent in contemporary business practices made it feasible for a company with widely diffused stock ownership to be controlled by an individual possessing only a minority percentage of shares.[80] Under the 1970 standard, an applicant is considered to be a bank holding company if it directly or indirectly exercises a controlling influence over the management or policies of the affiliate.[81] The flexibility this change gave the Board to find 'control' was designed largely to prevent potential abuse of the bank holding company device.

Several very important changes affecting the scope of permissible non-banking activities were made in Section 4. The Federal Reserve Board's authority for making decisions concerning the appropriateness of non-bank acquisitions by BHC's was considerably expanded. Among the changes was deletion of the 1956 exemption for companies of a "financial, fiduciary or insurance nature". Pursuant to the 1970 amendments, the Board was directed to authorize such activities, which in its discretion, are "so closely related to banking or managing or controlling banks as to be proper incident thereto...."[82] Also deleted from the original clause were the words "business of banking" in favor of simply, "banking". This change was brought about at the request of then Chairman of the Board, Arthur Burns, who wrote:

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[78] This definition effectively exempts foreign banks that do not do business with the U.S. except as an incident to their foreign activities. More importantly, under the Garn-St. Germain Depository Institutions Act of 1982, institutions chartered by the Federal Home Loan Bank Board or insured by the Federal Savings and Loan Insurance Corporation are also explicitly excluded. Public Law 97-320, §333, §404.

[79] Act of Dec. 31, 1970. Pub. L. No. 91-607 §101(a), 84 Stat. 1760.

[80] Bank Holding Company Act, note 14 supra, p.1214.

[81] Act of Dec. 31, 1970. Pub. L. No. 91-607 §101(a). 84 STAT 1760. The Act does provide the statutory presumption that companies controlling five percent or less of the stock of an affiliate be considered outside this test. Id.

> "We have in mind indicating that a non-bank subsidiary's activities should be related to banking (or managing or controlling banks) generally, rather than to the specific business carried on by the subsidiary banks of the particular holding company involved."[83]

There was clearly a dispute as to the expansion of the BHC's powers (and indirectly that of the Board). It is clear from the inability of the House and Senate to agree upon original versions of the Bill. The final language of Section 4(c)(8) was the product of the conference committee. The final form of the clause came from two drafts. The first was that of the House Conferees, the second was that of Chairman Burns.[84]

A chief concern among House members was that "a negative laundry list" be included which listed specific activities in which one bank holding companies and their subsidiaries were not to engage.[85] This reflected the general sentiment in the House that BHC's should be restricted to the more narrow standards of the 1956 Act. The 'laundry list' was finally abandoned in conference by a majority of the House members in exchange for Senate agreement to include the "closely related standard."[86]

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[82] Act of Dec. 31, 1970, Pub. L. No. 91-607 §103(4) 84 STAT 1764.

[83] Letter from Arthur Burns to Rep. Wright Patman, Nov. 25, 1970, in 116 Cong. Rec. H. 11,795 (daily ed. Dec. 16, 1970).

[84] For in-depth discussion see Comment, The Bank Holding Company Act, 39 Geo.Wash.L.Rev. 1209, 1220 (1971).

[85] 115 Cong. Rec. 33, 133-4 (1969). The activities prohibited included: maintaining travel agencies, providing data processing, providing auditing or other professional accounting services, selling mutual funds,operating insurance agencies.

[86] The Senate, along with the Federal Reserve Board, had sought to adopt a standard that called for an activity to be "functionally related" as a means of creating maximum flexibility. The Senate Bill originally reported included this language. S. Rep. No. 1084, 91st Cong., 2nd Sess. 12 (1970)

Additional regulatory duties were delegated to the Federal Reserve Board by the modification of certain procedural requirements. Section 4 includes the language "by order or regulation." The Board can thus determine which activities are closely related to banking by either rule or order.[87] The new language also provides for due notice and opportunity for hearings.[88] The responsibility for holding hearings on all applications is not, however, required. As we shall see in Part III, precisely when the Board is required to grant oral hearings and when they can, in effect, be dispensed with has proven to be somewhat ambiguous and has generated litigation and controversy.[89]

The other major change in the 1956 Act was the introduction of a public benefits test. In deciding whether a non-banking activity is closely related to banking, the Board was required to consider whether the activity's performance by a non-bank subsidiary of a bank holding company will:

> "produce benefits to the public, such as greater convenience, increased competition or gains in

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One commentator, upon reviewing the proceedings, concluded that in the overall context of the situation..."...the decision to retain the "closely related" language of the 1956 Act mars a compromise between the stringent bill passed by the House and the Senate's more liberal counterpart, and would seem to require the same interpretation recorded in the 1956 Act."

"The Federal Reserve Board, however, has indicated that it intends to give this Section a broader interpretation, one that would in essence construe the provision as though the "functionally related" language had been adopted. Less than one month after the new legislation was signed into law, the Board issued a proposed amendment to Regulation Y, which contained the Board's interpretation and policies toward holding companies, setting forth the non-banking activities which it regarded as falling within the scope of the new Section 4(c)(8).

[87] This provision provides the basis for the Board's issuance of Regulation Y.

[88] "Shares of any company the activity of which the board after due notice and opportunity for hearing has determined (by order or regulation) to be so closely related to banking..." U.S.C. §1843 (c)(5).

[89] These procedural issues are dealt with in detail in Part III, infra.

> efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practice."[90]

More concrete guidelines as to how the Board should impose this standard were not included in the Act. How broad the authority Congress intended to give the Reserve Board under this new test was disputed at the time of enactment. A minority felt that the imposition of this test made the standard more difficult than the 1956 law in that it provided a second obstacle to approval.[91] The majority, however, felt that the public benefits test "...frees the Board of the restrictive precedents established under the present Act..."[92] From a procedural point of view, the addition of this test ensured at least the possibility of a hearing. The Board could by rule or order determine what activities were closely related to banking. But each individual applicant nonetheless had to be prepared to show that engaging in an approved activity would also meet the public benefits test on a case by case basis.

(3) The Competitive Equality Banking Act of 1987 ("CEBA"). Of primary significance for this report is the fact that CEBA closes the "nonbank bank" loophole by redefining the term "bank" in the Bank Holding Company Act as an institution that either is insured by the Federal Deposit Insurance Corporation (the "FDIC") or both:

> (i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or other; and (ii) is engaged in the business of making commercial loans.[93]

The Conference Report states that a demand deposit includes any deposit account from which funds are transferred automatically and deposits withdrawable by check or similar means for payment to third parties including NOW accounts as well as accounts providing for electronic transfers to third parties. Commercial loans include broker call loans, the purchase of retail installment paper, loans to securities dealers, and overdrafts in the account of a business customer. The Act required immediate divestiture for companies that become bank holding companies as a result of the Act and that acquired, between March 5, 1987 and the enactment of the Act, a nonbank bank that is defined under the Act as a "bank."

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[90] 12 U.S.C. §1843(c)(8) 1976.

[91] 116 Cong. Rec. §20,640 (daily ed. Dec. 15, 1970). See Comments, supra, note 72 at p.1222.

[92] Id. 20, 640.

[93] P.L. 100-86, § 101.

PART III

The FED As An Administrative Agency

The purpose of part III of this report is to examine the Fed as it functions as an administrative agency. Our substantive context will be limited to an examination of aspects of the Board's implementation of the Bank Holding Company Act. Specifically, Part III will look at certain aspects of the FED's adjudicatory processes. In particular, this sections examines the adjudicatory procedures used by the FED to resolve disputes in the context of Section 3 and 4 applications under the Bank Holding Company Act. We shall begin by reviewing the procedures now in place and the case law that has developed to date.

A. The FED and Adjudication

As was noted in Part II, bank holding companies can facilitate expansion by banking organizations. This legal organizational form can avoid state and federal restrictions on geographic diversification and can also serve as a vehicle for product expansion.[94] From the regulated's point of view, the holding company form thus has a great deal of flexibility to offer and it has done much to change both the structure of banking and its regulation.[95]

This kind of flexibility, of course, was not the primary purpose of the Act. It was passed, as we have seen, for reasons such as fear of the anticompetitive effects BHC's are likely to have, as well as the concentration of power they represent. Section 3 of the Act, in particular, was passed to deal with BHC expansion. Before BHC's may be formed and additional banks acquired, Section 3 requires prior approval from the Board. No application can be approved if it violates the antitrust standards of either the Sherman Act or, with one exception, the Clayton Act.[96] In addition, the Board must consider the safety and soundness of these transactions.[97] In the non-banking area, holding company expansion is subject to even more strict requirements and, as we shall see, more specific, statutorily mandated procedures as well. We shall deal first with the procedural hearing requirements of section 3, namely those that are necessary before applications for the formation of new BHC's or the acquisition of a bank by a BHC may be granted or denied. We shall then examine the hearing procedures that relate to section 4 applications - i.e. those involving the control or the acquisition of ownership interest in non-banks by BHC's.

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[94] It is interesting to note that the Supreme Court's most recent decision has interpreted the McFadden Act in such a way as to encourage geographic expansion on the part of national banks and to increase competition in the securities industry. See, Clarke v. SIA, 107 S.Ct. 750 (1987).

[95] See Fischer, supra note 37, at p. 165.

[96] 12 U.S.C. § 1842(c).

Applications under either section can have a variety of substantive effects. From the point of view of the agency, they may raise new and important issues that have important policy implications. From the point of view of the regulated, they often can make a significant difference between levels of financial success or between success and failure. Moreover, the grant or denial of these applications can have important effects on third parties as well. The grant of an application, for example, can have an adverse effect on some competitors. There often is a strong incentive on the part of such third parties to be sure that the Board's ultimate decision is correct. Competitors can often shed light on the merits of a pending application by participating in the proceeding, but they also may have a significant interest in delaying the ultimate outcome, especially if it is likely to be adverse to their interests.

In addition to the various substantive interests of the parties involved (including the agency) and the way these interests properly or improperly shape their procedural demands, there is also a very practical aspect of the application process. Processing them takes time and resources. BHC applications have continued to flow to the Fed in record numbers in the 1980's. Their very numbers suggest both the importance and extent of the changes occurring in this industry. As Professor Fischer recently pointed out:

> In just six years, the number of BHC's had very nearly tripled, but this was merely one element of a vast change in the American banking structure begun in the early 1980's. Broader branch banking, nonbank banks, and interstate banking were to change the BHC's movement's thrust from intrastate to interstate and ultimately to nationwide banking. This was to be one of the most challenging periods faced by the Federal

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[97] 12 U.S.C. § 1842(3)(c).

Reserve Board in administering the BHCA, and, as this is written in 1986, it is far from over.[98]

(1) § 3 Procedures - The Expansion of Banking Interests

Prior approval by the Board is required before: (1) any company becomes a BHC; (2) any bank becomes the subsidiary of a BHC; (3) any BHC acquires ownership or control of more than 5 percent of any class of voting shares of any bank holding company; (4) any BHC or subsidiary (except a bank) acquires the assets of a bank; and (5) any BHC merges or consolidates with any other bank.[99] The statutory factors which the Board must apply in acting on Section 3 applications include an evaluation of the competitive impact of the transaction, the convenience and needs of the community to be served, and the financial and managerial resources and future prospects of the BHC and the banks concerned.[100] The procedures governing these application are set forth in section 3 of the BHCA.[101] The Board's own regulations are set forth in and Regulation Y in CFR.[102]

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[98] Fischer, supra note 37, at p. 239(emphasis added). Similarly, a report prepared by the Federal Reserve Board's own staff notes:

The Federal Reserve's domestic supervisory and regulatory activities should be considered in the context of two significant trends within the holding company movement. First, ... the number of bank holding companies and the percentage of commercial bank assets controlled by such companies have increased significantly since the passage of the 1970 Amendments. By bringing companies that owned just one bank under the statutory definition of bank holding companies, these Amendments increased the number of such companies supervised by the Federal Reserve from 121 in 1970 to 1,567 in 1971. In 1975, there were 1,821 bank holding companies controlling 69 percent of all commercial bank assets. By 1985, the number of companies had increased to 6,453 and such companies controlled over 90 percent of all commercial bank assets. While the overwhelming majority of bank holding companies have consolidated assets of less than $150 million, over 80 percent of aggregate holding company assets are held by large regional and multinational companies with consolidated assets in excess of $1 billion.

The Federal Reserve Board's Oversight of the Domestic and International Activities of U.S. Banks and Bank Holding Companies, in Appendices to Statement of Paul Volcker before the Subcommittee on Commerce and Monetary Affairs of the Committee on Government Operations of the U.S. House of Rep., June 11, 1986, p. B-1.

[99] 12 U.S.C. § 1842.

[100] 12 U.S.C. § 1842(c).

Pursuant to the Board's regulations, applications for formation or expansion of a BHC are filed initially with the Federal Reserve Bank of the district in which the head office of the bank holding company is located, rather than directly with the Board.[103] Prior to this filing, notice must first be published in a general circulation newspaper.[104] The Reserve Bank then investigates and prepares a report on the relevant facts; the report is submitted to the Board along with the Reserve Bank's recommendations on the application.[105] Reserve Banks usually cooperate with applicants in an informal way, and help to "clean up" applications before they are sent on to the Board with their recommendation. When the Board receives the Reserve Bank's report and recommendations "the Board's staff prepares and submits to the Board comments on the subject."[106] The Board may then take "such action as it deems appropriate in the public interest."[107] As a recent Board report makes clear, there is a good deal of give and take in this process:

> The scrutiny involved in the applications process provides an important discipline on the behavior of banking organizations. Thus, applications are often responsive to suggestions from the Federal Reserve for improvements in their condition or for changes to their proposals in order to limit adverse effects and thereby increase the chances for approval. Applications often take action to improve their condition even before filing proposals.... *[W]hile only a relatively small percentage of proposals is denied, a significant number are modified after filing. Others are withdrawn, at least until remedial changes can be effected. Through this process, banking organizations are encouraged to constrain their expansion to appropriate levels, to*

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[101] 12 U.S.C. § 1842(b).

[102] 12 C.F.R. § 225 *et seq*.

[103] 12 C.F.R. § 262.3(c).

[104] 12 C.F.R. § 262.3(b)(vi).

[105] 12 C.F.R. § 262.3(d).

[106] 12 C.F.R. § 262.3(d).

[107] 12 C.F.R. § 262.3(f).

> avoid excessive risk-taking and, if necessary, to improve their condition.[108]

This kind of negotiated regulation is not usually susceptible to formal or even informal adversarial hearings. This kind of negotiated applications process increases efficiency and provides the agency with an opportunity to tailor its decisions to the individual applicant. As we shall discuss in Part IV, some problems may arise, however, if there are conditions or informal suggestions made that perhaps go beyond the agency's authority or represent a policy that has not been officially established or published. A party eager to close a deal may not feel it has much negotiating room. In such a case, the Board has superior bargaining power.

The regulations also provide for comments and timely, written requests for a hearing. Such requests must include a statement of why a written presentation would not suffice in lieu of a hearing, identifying specifically any questions of fact that are in dispute and summarizing the evidence that would be presented at a hearing.[109] If adverse comments are received from any interested party, the applicant receives a copy and an opportunity to respond in writing. If there are no adverse comments, the matter is ready for Board action.[110]

It is important to note that, in addition to the Board's own regulations, Section 3 of the Act requires the Board to give notice to the Comptroller of Currency if a national bank is involved or the relevant State supervisory authority if a state bank is involved. Their "views and recommendations shall be submitted within thirty calendar days of the date on which notice is given or within ten calendar days of such date if ... an emergency exists requiring expeditious action."[111] The statute then goes on to state:

> If the thirty-day notice period applies and if the Comptroller of the Currency or the State supervisory authority so notified by the Board disapproves the application in writing within this period, the Board shall forthwith give written notice of that fact to the applicant. Within three days after giving such notice

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[108] Board Report, supra note 91, p. B-6. (emphasis added)

[109] 12 C.F.R. § 262.3(e).

[110] See 12 C.F.R. § 262.3 (e).

[111] 12 U.S.C. § 1842(b).

> to the applicant, the Board shall notify in writing the applicant and the disapproving authority of the date for commencement of a hearing.... Any such hearing shall be commenced not less than ten nor more than thirty days after the Board has given written notice to the applicant of the action of the disapproving authority. The length of any such hearing shall be determined by the Board, but it shall afford all interested parties a reasonable opportunity to testify at such hearing. At the conclusion thereof, the Board shall, by order grant or deny the application on the basis of that record made at such hearing.[112]

If a section 3 hearing is statutorily required, i.e., if there is a denial issued within thirty days, the hearing provided is a full-blown trial-type adjudicative hearing under sections 556 and 557 of the APA, pursuant to the Board's own rules of practice for hearings.[113] These hearings thus contemplate a hearing examiner, the admission of parties, testimony under oath, cross-examination, rules of evidence and, ultimately, a decision on the record. The Board has the right to waive this hearing for emergencies such as the need to act immediately to prevent a probable bank failure. Where no section 3 statutory hearing is required, the Board can, in its discretion, grant requests for a formal hearing submitted by interested parties even if the Comptroller or state officially involved do not object to the application.[114]

As a practical matter, my interviews have indicated that such hearings are seldom granted. It may be that once an applicant believes his application will be denied, he withdraws the application to make whatever changes are necessary. The lack of hearings in this regard may also be due to the fact that if the Comptroller or state authority involved wishes to deny the application, they simply wait for the 30 day period to run and then express their disapproval. This, of course, does not mean that there is no hearing, but any such hearing that is granted is discretionary with the Board.[115]

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[112] 12 U.S.C. § 1842(b).

[113] See 12 C.F.R. Part 263. See also, 12 C.F.R. §§ 261.3(a) and 263.4 which requires notice of these formal hearings to be published in the Federal Register.

[114] 12 C.F.R. § 262.3. See e.g., Farmers & Merchants Bank v. Board of Governors, 567 F.2d 1082 (D.C. Cir. 1977).

As we shall see below, these section 3 hearings requirements raise some statutory reform questions. Given the apparent use of the statute and the fact that full adjudicatory hearings rarely result, would it be wise simply to amend the statute to reflect reality?

Section 3 also sets forth a statutory time limit as far as Board decisions are concerned. Specifically, it states:

> In the event of the failure of the Board to act on any application for approval under this section within the ninety-one-day period which begins on the date of submission to the Board of the complete record on the application, the application shall be deemed to have been granted.[116]

There has been considerable dispute as to when the 91 day period actually begins to run. When, for example, is the Board's record actually complete? Does a new 91 day period begin when the applicant submits new information? These kinds of issues have been litigated[117] and were, in part, responsible for the Federal Reserve Board's revisions of its regulations in 1983. The Board's regulations provide, in pertinent part, that:

> For the purpose of computing the 91 day period, the records shall be regarded as complete on the latest of:

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[115] The Board appears to read this provision strictly. See e.g., Federal Reserve System, First Bank System, Inc., Minneapolis, Minnesota (Feb. 29, 1988). The Board noted that it had "received comments from the Minnesota Commissioner expressing his concern about the competitive effects of this acquisition. Although the Commissioner did not disapprove First Bank's application, he requested . . . a public hearing to consider the application. Because the Commissioner did not recommend denial of the application, The Board is not required to hold a hearing." 12 U.S.C. § 1842(b).

[116] 12 U.S.C. § 1842(b). Section 4 of the BHCA contains a similar provision that applies to applications submitted by bank holding companies under section 4(c)(8). See 12 U.S.C. § 1843(c).

[117] See, e.g., Republic of Tex. Corp. v. Board of Governors, 649 F.2d 1026, (5th Cir. 1981) and the cases cited at pp. 1034-43.

(i) The date of receipt by the Board of an application that has been accepted for processing by the Reserve Bank;

(ii) The last day provided in any notice for receipt of comments and hearing requests on the application;

(iii) The date of receipt by the Board of the last relevant material regarding the application that is needed for the Board's decision, if the material is received from a source outside of the Federal Reserve System; or

(iv) The date of completion of any hearing or other proceeding [ordered by the Board].[118]

Each of these dates for commencement of the 91-day rule period reflects court decisions interpreting the rule. Because the 91-day period may be affected by certain processing events, including the publication of notice that the application has been submitted or acceptance of the application by the Reserve Bank for forwarding to the Board, the Board's regulations provide detailed rules regarding each step of the applications process. For example, the Board's regulations regarding processing of applications received under section 3 of the BHCA provide that, upon receipt of an application, the Reserve Bank shall promptly furnish notice of the application to the appropriate banking supervisor, and notice of the application shall be promptly sent to the Federal Register for publication. The regulation also provides that the Federal Register notice shall invite public comment for a period of no longer than 30 days.[119]

The regulations also provide that within ten business days after an application has been received by the Reserve Bank, the Reserve Bank shall accept the application for processing, notify the applicant that additional information is necessary to complete the application if it is substantially incomplete.[120] If additional information is necessary, the Reserve Bank must, under the Board's regulations, either accept the application for processing or return it to the applicant if it continues to be incomplete within five business days of receiving the additional information requested by the Reserve Bank.[121] Finally, the Board's regulations provide that upon acceptance of the application, the Reserve Bank must immediately forward the application to the Board.[122]

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[118] 12 C.F.R. § 225.14(g)(2). These regulations apply to both section 3 and section 4 applications. See 12 C.F.R. § 225.23(h).

[119] 12 C.F.R. § 225.14 (b).

[120] 12 C.F.R. 225.14 (c).

Despite these rules and clarifications, a number of questions arise. Can the Board begin the 91-day rule anew by requesting new information? If so, how significant must this request for information be? In a small number of cases, there can be and often is some confusion concerning the retriggering of the 91-day rule. Given the fact that circumstances and economic conditions often change, new information is often required. As we shall see in Part IV, the ability to start and stop the running of this rule can be perceived as significant in the bargaining relationship that develops between staff and the applicant.

There are other ambiguities as well. For example, "the effect of the elapse of the ninety-one day period on the rights of protestants to an application is unclear."[123] It would seem to place the burden of showing that statutory criteria have not been met on these protestants.[124] It also is unclear whether an acquiree is entitled to the requirements of the rule or whether those rights could be waived by the applicant.

In addition, if the ninety-one day period expires and approval is thus assumed, how can the applicant proceed to complete the transaction?[125] This is a particularly relevant question if the Board does *not* believe the ninety-one days have transpired. If an applicant asks the Board for a ruling and it is negative, is that order appealable or must the applicant await the Board's final order? This could be very important particularly given the fact that acquisition or merger deals are fluid situations often requiring very prompt action.[126] The applicability of the 91-day rule to an acquisition of an activity prohibited by Congress also is unclear.[127]

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[121] *Id.*

[122] *Id.*

[123] P. Heller, Federal Bank Holding Company Law, § 7.04, pp. 7-25 (Law Journal Seminars Press, 1986)(hereinafter cited as Heller).

[124] *Id.* *See also*, Bank America v. Board, 596 F.2d at 1368.

[125] *Id.*

Even with these ambiguities, it would appear, based on a Federal Reserve Board Staff Report, that most applications that are not withdrawn are processed efficiently. As that report notes:

> The Board's Regulation Y and internal operating procedures make timeliness a principal objective in the applications process. Although the Act provides that the Board may take up to 91 days after the submission of the complete record, procedures were voluntarily developed in 1971 that established internal processing periods substantially shorter than those reburied by statute. Since that time, the internal goals of 90 calendar days has been reduced to 60 days and processing efficiencies have continued. In addition, the Board has developed a "notification" process for certain bank holding company proposals that normally do not present any issues. Thus, a bank holding company need only notify the Reserve Bank--rather than receive prior approval--for the acquisition of a de novo permissible nonbanking firm, the acquisition of a "small" nonbanking going concern, or the redemption of the bank holding company's shares. After a waiting period of 15-30 days from acceptance, the proposal may be consummated unless objected to by the Reserve Bank. Several hundred such proposals are processed by the System each year.

As indicated above, the Board has, over time, been concerned that applications be processed in as timely a manner as possible, and in the early 1970's established an objective processing 90 percent of all applications within 90 days. The Board modified this goal in 1983 to process 90 percent of all applications within 60 days. These processing objectives have been met every year since 1977. In 1985, the Federal Reserve processed 96 percent of all applications within the 60 day period.[128]

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[126] See generally, Bank America v. Board, 596 F.2d 1368, 1374-74 (9th Cir. 1979).

[127] See, e.g., North Lawndale Eco. Develop. Corp. v. Board 553 F.2d 23 (7th Cir. 1977).

[128] The Federal Reserve Board's Oversight of the Domestic and International Activities of U.S. Banks and Bank Holding Companies p. B-6. Part of Appendices to Statement by Paul A. Volcker, Chairman, before the Subcommittee on Commerce, Consumer

It is not the purpose of this report to examine exhaustively the various issues that the 91-day rule may raise when applied in various contexts. This report will, however, later examine the relationship of this rule to the bargaining process described in Part IV.

(2) Section 4(c)(8) - Non-Banking Activities

The procedures outlined above apply to section 3 applications - i.e. applications to expand banking interests. In cases such as these, the Board is primarily concerned with the competitive impact of the application. It must reject any application which would create a monopoly or which would be in furtherance of any conspiracy to monopolize the business of banking. In addition, section 3(c) of the Act forbids the Board to approve any application if the effect of the transaction, in any section of the country, is substantially to lessen competition or to tend to create a monopoly, or which in any manner would be in restraint of trade. Under this standard, however, the Board can still approve a transaction if it determines that the anti-competitive effects are outweighed by the public interest benefits of the transaction.[129]

In contrast, Section 4(c)(8) involves non-banking interests. It authorizes Board approval only of holding company acquisitions of nonbanking entities whose activities are "closely related" to and a "proper incident" of banking. The acquiring holding company must apply to the Board for approval under this non-bank provision of the Act.

One federal court of appeals stated recently, "[a]s we write, an avalanche of applications by bank holding companies seeking to establish hundreds of deposit taking institutions

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and Monetary Affairs of the Commission of Government Operations of the U.S. House of Rep. (June, 1986).

During 1986, the Board processed a total of 1,681 applications under the BHCA. The Board processed over 93 percent of those applications within the 60 day period provided in the Board's regulations. See Annual Report of the Board of Governors of the Federal Reserve System, pp. 196, 198 (1986). The remainder of the cases were considered by the Board within the 91-day rule.

[129] 12 U.S.C. § 1842(c).

across state lines is in progress."[130] To some extent, this activity was due to the so-called non-bank loophole, a loophole that has now been closed by the Competitive Equality Banking Act of 1987.[131] Nevertheless, section 4(c)(8) continues to be an important vehicle for non-bank acquisitions, particularly those involving insurance and securities activities.

The relevant portions of the BHCA permit bank holding companies to acquire "shares of any company the activities of which the Board *after due notice and opportunity for hearing* has determined (by order or regulation) to be so closely related to banking or managing or controlling banks as to be a proper incident thereto . . . . In determining whether a particular activity is a proper incident to banking or managing or controlling banks the Board shall consider whether its performance by an affiliate of a holding company can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interest, or unsound banking practices. . . ."[132] In practice, the Board's "so closely related to banking . . . as to be a proper incident thereto" determination is based upon other specific provisions of the BHCA, along with regulations formulated and adopted by the Board in its Regulation Y.[133] As such, it is typically a straightforward application of pre-existing and generalized standards.[134]

The second determination--whether the benefits to the public can reasonably be expected to outweigh the possible adverse effects--must be made on an application-by-application basis "after due notice and opportunity for hearing." Not surprisingly, existing competitors and trade associations often oppose a holding company's proposed entry into "their" market on public benefit grounds. Although the issues inherent in the public benefit determination often may be adequately aired in written submissions to the Board, opponents of a holding company's application may allege various "adverse effects" and demand that the Board permit discovery and conduct a full evidentiary hearing on the matter. Whatever the merits of these requests, providing for trial-type hearing procedures virtually guarantees a protracted--and more expensive--application process; conversely, by denying a protestant's request for a hearing, the Board runs the risk of providing the protestant with a viable issue for judicial review.

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[130] Florida Dept. of Banking v. Board of Governors, 760 F.2d 1135, 1138 (11th Cir. 1985).

[131] ____ U.S.C.A. ____.

[132] 12 U.S.C.A. § 1843(c)(8) (1985) (*emphasis added*).

[133] *See, e.g.*, Regulation Y, 12 CFR Part 225 (1985).

[134] 12 C.F.R. § 225.23(b). Going concerns, however, require applications with the Federal Reserve Bank. See 12 C.F.R. § 225.23(c).

The question of when to grant a protestant's request for a hearing looms as a procedural obstacle for both the Board and expanding holding companies. One commentator has contended that because of the confusion over when a hearing is necessary, "opponents (of holding company acquisitions) sometimes have been able to tie up applications for months or even years in expensive and time-consuming administrative proceedings of questionable value."[135]

The problem has resulted in a split of authority among the federal circuits reviewing the Board's § 1843(c)(8) determinations. All courts recognize that an agency need not order a hearing unless it determines that there are disputed issues of material fact whose resolution will bear on the matter at hand.[136] Put another way, courts also agree that the Board is not obligated to order a hearing on a particular application if a hearing would serve no purpose.[137] Nonetheless, they appear to disagree as to the type of information that a protestant must initially proffer in order to establish a disputed issue of fact, thereby triggering the hearing requirement.

In *Independent Insurance Agents of America, Inc. v. Board*,[138] the IIAA opposed Mercantile Bancorporation's application to sell credit-related property and casualty insurance through a non-bank subsidiary. Although these activities were among those approved by the Board and listed in Regulation Y as being "closely related" to banking, the IIAA nevertheless challenged the acquisition on public benefit grounds, contending that in this case the possible adverse effects of this acquisition outweighed the public benefits. Specifically, they contended that customers would purchase insurance from the subsidiary in order to improve their chances of getting a loan from the bank, that the insurance would be priced above competitive levels, and that consumers would be deprived of the services of an agent. The Board requested the protestants (IIAA) to file detailed descriptions of their objections and the issues they wished to explore in a hearing. After requiring Mercantile to submit additional information in response to the protestants, charges, and after then allowing the protestants to respond to Mercantile's additional submissions, the Board denied the request for a hearing and approved the application.

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[135] Helfer and Morse, "Hearings Under Section 4(c) (8) of the Bank Holding Company Act," 101 Banking Law Journal 50 (1984). This excellent article goes on to recommend an approach to section (4)(c)(8) hearings that now seems largely to be followed by the Board.

[136] See e.g., Ohio Power Co. v. F.E.R.C., 744 F.2d 162, 170 (D.C. Cir. 1984).

[137] *See* Connecticut Bankers Ass,n v. Board, 627 F.2d 245, 250-51 (D.C. Cir. 1980); Independent Bankers Ass,n of Georgia v. Board, 516 F.2d 1206, 1220 (D.C. Cir. 1975); American Bancorporation, Inc. v. Board, 509 F.2d 29, 39 (8th Cir. 1974).

[138] 658 F.2d 571 (8th Cir. 1981).

The Eighth Circuit vacated the approval, reasoning that "the Board's refusal to hold an evidentiary hearing prevented the IIAA from substantiating its claim that [Mercantile's] activities would not result in overall net benefits to the public."[139] Despite the Board's seemingly careful review of written submissions and resubmissions, the court rejected the argument that IIAA's objections were mere speculation. The court stated that "[t]he Board cannot deny a request for an evidentiary hearing when, as here, it is presented with legitimate contentions which place material facts in dispute."[140] Upon remand, the Board conducted a full evidentiary hearing before again approving Mercantile's application __ over 2 1/2 years after the Board had initially approved the proposal.

In contrast to the Eighth Circuit, the D.C. Circuit has adopted a seemingly more restrictive view of a protestant's right to an evidentiary hearing. In Connecticut Bankers Ass'n v. Board,[141] the D.C. Circuit substantially upheld the Board's decision to deny the protestant Association's request for a hearing, stating that "a protestant does not become entitled to an evidentiary hearing merely on request, or on a bald or conclusory allegation that such a dispute exists. The protestant must make a minimal showing that material facts are in dispute, thereby demonstrating that an 'inquiry in depth' is appropriate."[142] The protestants had opposed Citicorp's application to establish a non-bank subsidiary through which it planned to sell credit-related insurance and second-mortgage loans; although these activities were approved by the Board's Regulation Y, the Association alleged that the adverse effects of the operation--undue concentration of economic resources, diminution of competition, and unfair competition against Connecticut banks--would outweigh the public benefits.[143]

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[139] Id. at 576.

[140] Id.

[141] 627 F.2d 245 (D.C. Cir. 1980).

In *Connecticut Bankers*, the Board had required applicant Citicorp to provide specific and detailed answers to the protestants' questions, had allowed the protestants to make an informal oral presentation to the Board's staff to develop and clarify issues of fact, and had reviewed written arguments in support of the hearing request before denying the request "because there [were] no facts in dispute that bear upon the determination the Board must make."[144] Although the D.C. Circuit remanded the case to the Board for further reconsideration of certain issues, it did not *order* the Board to conduct a hearing. The court observed that protestants, evidence of Citicorp's great size and proliferation of lending subsidiaries did not themselves raise issues of material fact; nor had the protestants offered any reason why the Board could not rely on Citicorp's representation that it would not operate the subsidiary as a branch.[145]

Unlike the Eighth Circuit, the D.C. Circuit was not of the view that "legitimate *contentions* . . . place material facts in dispute."[146] Instead, it required evidence--"as contrasted with mere possibility or speculation"[147]--to dispute a fact asserted or denied by the applicant. The D.C. Circuit also indicated that even when a protestant has raised an issue of fact, the Board need not grant a hearing if the issue is not material to the Board's determination. Moreover, the Board's conditioning of its approval on the applicant's acceptance of Board-imposed operating restrictions may also preclude the necessity of a hearing.[148] Upon remand, the Board required Citicorp to file a written submission on how it planned to minimize the danger of unfair competition. Again concluding that there was no issue of material fact in dispute, the Board once again approved Citicorp's application without a hearing.[149]

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[142] *Id*. at 251.

[143] *Id*. at 247.

[144] *Id*. at 248.

[145] *Id*. at 253.

[146] 658 F.2d at 576 (emphasis added).

[147] 627 F.2d at 252. 254.

Both the Fourth and the Tenth Circuits appear to subscribe to the D.C. Circuit's more restrictive view of a protestant's right to a hearing under the non-bank exception to the BHCA.[150] Indeed, albeit in consideration of a different portion of the BHCA, a recent Eighth Circuit decision relied heavily on the D.C. Circuit's view in ruling that a protestant was not entitled to a hearing.[151] The approach prevailing in other Circuits is unclear, or has yet to be addressed; it is clear, however, that the courts,--and the Board's--handling of the hearing requirement will affect the pace of holding companies, non-bank expansion.[152] As shall see below, the Board has opted for an approach that allows hearings only if a material issue of fact is in dispute and an evidentiary hearing is necessary to resolve it. This has resulted in very infrequent adjudicatory hearings and it appears to have been an appropriately fair resolution of these issues.

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[148] *Id*. at 258.

[149] Citicorp, 67 Fed. Res. Bull. 443 (April 16, 1981).

[150] *See* Independent Insurance Agents of America, Inc. v. Board, 646 F.2d 868, 869-70 (4th Cir. 1981); Oklahoma Bankers Ass,n v. Federal Reserve Board, 766 F.2d 1446, 1451-52 (10th Cir. 1985).

[151] *See* Huston v. Board of Governors, 758 F.2d 275, 284 (8th Cir. 1985).

[152] *See. e.g.*, Association of Data Processing v. Board of Governors, 745 F.2d 677 (D.C. Cir. 1984) (protestants, petition for appellate review denied but only *after* more than three years of administrative proceedings, including "the exchange of more than a dozen letters, a prehearing conference, the presentation of nearly I,700 pages of oral and written testimony, examination and cross-examination of 11 witnesses, seven days of hearings over four months, introduction of over 350 exhibits, a recommended decision of the administrative law judge, and formal Board approval of the application." Helfer and Morse, 101 Banking Law Journal at 57, n.25).

B. Summary and Recommendations To Be Considered

The full adjudicatory hearing provisions in section 3 appear to be irrelevant. The full adjudicatory hearing required if an application is denied within 30 days by the Comptroller or state official seldom if ever occurs. Potential denials are likely to be withdrawn before denial occurs and then resubmitted. If they are not, the wording of the statute seemingly would allow for the comptroller or state's denial after the 30 day period has run. In reality, disputes pursuant to section 3 are handled largely at the procedural discretion of the Board. The Conference should recommend that this statute be amended to make such hearings discretionary with the Board. The Board has handled these issues fairly. There is no need for a full blown adjudicatory hearing in most cases, even if the application is denied by the state or the Comptroller General. The statute, as written, is easily circumvented and adds little to the process needs of these cases.

Section (4)(c)(8) of the BHCA specifically calls for "an opportunity for a hearing" in cases involving applications to engage in non-banking activities. After the litigation set forth in this report regarding just when a hearing is, in fact, required, it now appears that the Board seldom grants evidentiary hearings unless there is a material issue of fact in dispute and an evidentiary hearing is necessary to resolve this dispute. On occasion, such hearings are held, but they are rare. This approach is appropriate for most cases. By and large, the Board appears to be responsive to the input of all interested parties, without causing undue delay or adding additional costs through unnecessary hearings.

Section (4)(c)(8) however, could be amended to reflect more accurately the more informal discretionary approach taken in these cases. Such an approach could treat Section 4 hearings the same as Section 3 hearings. On the other hand, the procedural rights of protestants (competitors) may be best protected and certainly are perceived as being best protected by a hearing provision statutorily required. Given the fact that the statute has now been interpreted in a manner that now satisfies the various interests involved, it may be best for the Conference simply to affirm the procedural accommodations and compromises that have now been worked out. They strike a good balance among the values of accuracy, efficiency and fairness. In this regard, it is interesting to note that the proposed Financial Institutes Deregulation Act would have completely eliminated the hearing language of section (4)(c)(8), thus leaving these procedures completely to the discretion of the Board.

PART IV

Bargaining For Justice--Regulatory Conditions and Voluntary Commitments

Part III was concerned primarily with the question of when the FED will hold an adjudicatory hearing to resolve disputes that arise in the context of section 3 and section 4 Bank Holding Company Act applications. As we have seen, full blown formal hearings are used sparingly and most hearings are of a more informal nature. These hearings, both formal and informal, are implicitly based on an adversarial model of administrative law. They assume that there are disputes over facts, law or both and that some kind of hearing before a neutral third party is necessary to resolve them. At the very least, they assume decisions capable of meaningful judicial review.

Part IV now examines the FED as it functions in an even more informal manner. It will set forth three distinct phases inherent in the applications process established by Congress under the BHCA. Each phase is subject to its own implicit model of dispute resolution. These phases are (1) the informational phase of the process, (2) the bargaining phase and (3) the adjudicatory or adversarial phase. Part IV will examine the bargaining phase of the process, particularly as this phase is reflected in the FED's use of conditions and voluntary commitments. It will also examine the assumptions that underlie this bargaining model, point out why that model is not necessarily fully applicable in an agency setting such as this, and make recommendations that might help ensure additional fairness without undercutting agency flexibility.

A. Three Models--An Overview.

Most applicants do not reach the formal hearing or purely adversarial stage of the process. Their application may be uncontroversial and thus routinely approved. On the other hand, if it is controversial, an applicant may receive some preliminary indications from staff concerning the problems that appear to exist with the application as initially presented. At this preliminary stage, an applicant may withdraw the application, particularly if it appears that it is going to be denied; he also may try to revise and amend it in ways that are responsive to the concerns of staff. This phase of the administrative process is based less on an adversarial model and more on first an informational model and then, ultimately, on a bargaining or negotiation model of the administrative process.

On an informational level, an applicant may not have supplied the proper data and information necessary for the Board to Act. The application is thus deniable because it is informationally incomplete. At this very preliminary stage of the proceeding, the agency, through its staff, is simply communicating to the applicant what information the Board will need before it can begin to consider seriously the merits of its proposal. In its purest form, this phase of the process involves no disputes over facts or law; it simply seeks to obtain all of the information necessary to reach the next, more judgmental part of the process. Of course, the informational and the judgmental can be linked. The information sought and that provided depends on the respective theories of the case that the staff and the applicant may have. To the extent those theories significantly differ, requests for information, as well as what information is considered relevant or irrelevant, are likely to reflect these differences. As we shall see below, the 91-day rule can also come into play. New requests for information can extend the time period the agency has to make its decision. Controversial cases--i.e., cases in which the theory of the case held by staff differs significantly from that of the applicant--can take more than 91 days to resolve. Theoretically, at least, the information phase of the process should be distinct and separate from the more judgmental phases of the process. In most instances, this is the case.

Assuming an application that is informationally complete, however, the next stage of the proceedings is much more substantive. The agency will begin to react to the application on its merits. The merits include, of course, not only what the applicant seeks to accomplish but who that applicant is. Quite apart from the comparative effects of its proposed acquisition or the degree to which the nonbank it wishes to acquire is related to banking, what is the financial status of the applicant? Can it successfully do what is seeks permission to accomplish? In addition, the Board must also consider the longer term policy implications of granting or denying certain applications. Indeed, at least three decision-making factors interact when the Board reaches the merits of an application--the legal requirements of the Act, the factual context of a particular applicant and the policy implications of allowing that applicant to pursue the course of action it proposes.

Once the application is informationally complete, a bargaining or negotiation model of agency decision-making usually takes over. From a pure, theoretical point of view, this model of dispute settlement differs from the adversarial model inherent in the adjudicatory hearings examined in Part III. Though oversimplified, especially as applied to the administrative process, the difference between these two, pure models are nonetheless helpfully captured by Professor Gulliver's description below:

> . . . the picture of negotiation is one of two sets of people, the disputing parties or their representatives, facing each other across a table or from opposite sides of an open space. They exchange information and opinion, engage in argument and discussion, and sooner or later propose offers and counter offers relating to the issues in dispute between them, seeking an outcome acceptable to both sides. The comparable picture of adjudication is that of two [or more] parties . . .who, separated from one another, face an adjudicator who sits in front of, apart from, and often raised above them. They address him, offering information, opinion, and arguments. Each seeks to refute the other's presentation and to persuade the adjudicator to favor his own case. Eventually the adjudicator pronounces his decision on the issues, often sorting out and summing up the information given to him and explaining his judgment.[153]

Clearly, the crucial differences between the two models is the absence of the third party decision-maker that marks the formal adjudication carried on at the FED on rare occasions, but also marks the more informal hearings provided by the Board. Of course, given the fact that final Board orders are subject to judicial review, that neutral third party may, theoretically at least, enter the process at a later point in the proceedings.

In reality, however, most Board proceedings, particularly the early stages of the applications process, more accurately fit within the negotiation or bargaining model of the process. The decision is more the result of negotiations between staff and the applicant. It appears to be, and often is, a joint decision. Theoretically, at least, each party can only obtain what the other is in the end prepared the allow. If staff and the applicant have a different view of the legal significance of the facts presented in a particular application, the informal discussions and bargaining that occurs concerning these differences may enable them to move toward the other. It is in this phase of the process that regulatory conditions and voluntary commitments can and often do play a significant role. They are the currency of the negotiating process.

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[153] P.H. Gulliver, Disputes and Negotiations, p. 3 (Academic Press, 1979).

A condition is a well established regulatory device that enables an agency to tailor its decision to the peculiarities of the applicant before it, further a policy goal it wishes to achieve, or both. It allows the agency to both grant the benefit that the applicant seeks, but at the same time obtain some assurances in exchange. These conditions can vary from being very fact specific and peculiar to the individual applicant before it, to a representation of a general policy that may or may not be implicated directly by the facts of the case before it. Since conditions usually appear in final agency orders, they theoretically can be tested by the adversarial stage of the proceedings available through judicial review. Of course, judicial review is not that common and, more significantly, many conditions do not necessarily appear in the final order.

This is particularly true when they take the form of voluntary commitments. They are usually found in letters of transmittal between the FED and the applicant. Confidentiality may require that they not be included in the final order. If they are truly voluntary, they may also represent a very fact specific agreement between the Board and the applicant that may have little general value and no real precedential effect. Such commitments may very well be the result of a bargaining process and genuinely represent voluntarily imposed requirements on the part of the applicant to meet the real, regulatory concerns of the FED. In many cases, these commitments are volunteered by applicants in the hope of expediting the decision-making process. As we shall see below, however, this is not always the way applicants view the voluntariness of the commitments they are asked to make.

It is impossible to segregate these three phases completely. Clearly, the informational, bargaining and adjudicatory models of dispute settlement, particularly as applied to the administrative process, overlap and intersect in many ways. We have already discussed how the informational needs of the agency can, on occasion, implicate the merits and the more judgmental aspects of the bargaining process. Similarly, the bargaining stage, particularly at the FED, has adjudicatory overtones, particularly when what often is in contention is not the significance of the facts presented by a particular applicant, but broader questions of law and policy. Given the relatively unequal bargaining power of the applicant as compared to the staff person reviewing that application, staff can easily take on the qualities of an adjudicator as well as a negotiator.

This is particularly true, given the fact that resort to the courts or certainly to formal adjudicatory hearings under Sections 3 and 4 is relatively rare. This is also the case when, in some contexts, a realistic appeal to the Board itself is also unlikely. Voluntary commitments have a way of becoming a fait accompli, making Board involvement in their policy implications unlikely and judicial review very difficult. Voluntary commitments are considered often a kind of waiver of an applicants' views on the law and policy inherent in the commitments.

Theoretically, however, the bargaining stage of the process is different than the adjudicatory or adversarial phase. There is no third party to determine what the outcome will be. The only outcome is the one to which both disputants agree to, even though the reasons for acceptability for each party are likely to be very different. The legal monopoly that the FED has on the regulatory benefits sought by applicants in Section 3 and Section 4 cases severely affects the relative bargaining strength of the applicant when compared to the Board.

Despite this potential mismatch, however, the ability and opportunity for applicants to bargain is extremely important to the success of the applications processes established by Congress in the BHCA. Of vital importance is the flexibility that this process provides. This decision-making flexibility is, in most cases, preferable to the all or nothing consequences of having either to grant the application as requested, or to deny it outright. The very nature of an individually-oriented, applications process is that an agency can and should tailor its regulatory powers to the case at hand. As we shall see, however, there are some definite risks attached to this kind of regulation as well. While most cases may be handled in a routine fashion, some of the more difficult cases can give rise to serious questions concerning the substance of and the extent to which some commitments are extracted or accepted.

The remainder of this report will examine more fully the somewhat modified bargaining model that gives rise to various kinds of conditions and commitments commonly used by the FED. To provide a broad legal framework for what an appropriate use of an agency's conditioning power should be, we shall briefly set forth the approach that Courts have taken when reviewing conditions imposed by Congress, particularly when it exercises its spending power. With this as background, we shall then examine the use of conditions and commitments at the agency level in general, and particularly at the FED.

B. Unconstitutional Conditions And The Spending Power

Conditions have always been an important regulatory tool and a source of considerable governmental power. This form of regulatory power has grown as the power of the government has grown. The more benefits or largess government provides, the more opportunities there are for the government to condition the grant of these benefits on the extension of various policies and goals. A large legal literature has grown dealing with the constitutional limits on Congress in its use of conditions.[154] A full review of these cases and literature is outside the scope of this report, but it is a useful starting point to examine the constitutional limits on the use of conditions set forth by the Supreme Court in a recent case dealing with the congressional spending power.

In South Dakota v. Dole,[155] the state of South Dakota challenged the constitutionality of a federal statute that conditioned the states' receipt of a portion of federal highway funds on the adoption of a minimum drinking age of 21. South Dakota permitted persons 19 years of age or older to purchase beer containing up to 3.2% alcohol. The state contended that Congress' decision to condition highway funds in this way was a violation of its spending power and the Twenty First Amendment. That Amendment granted the states virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system. South Dakota argued that conditioning federal highway funds on action that was clearly reserved to the discretion of the states was unconstitutional.

Chief Justice Rehnquist disagreed. Writing for the majority, he held that Congress had acted constitutionally by indirectly encouraging uniformity in the States' drinking ages. This was so even if one were to assume that Congress could not, under the Twenty First Amendment, directly regulate drinking ages. Though his opinion provided Congress with very broad conditioning powers, they were not without limits. Justice O'Connor, in dissent, succinctly set forth those limits and argued that one of them applied in this case. These limitations were:[156]

> (1) . . .the expenditures must be for the general welfare. . . (2) the conditions imposed must be for the general welfare . . . (3) the conditions imposed must

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[154] For a thorough rendition of this literature and the key cases that have arisen, see Kreimer, Allocational Sanctions: The Problem of Negative Rights In A Positive State, 132 U.Penn.L.Rev. 1293 (1984).

[155] 107 S.Ct. 2793 (1987).

[156] Id. at 2799.

> be unambiguous. . . (4) they must be reasonably related to the purpose of the expenditure.

In Justice O'Connor's view, condition four was not satisfied in this case: "establishment of a minimum drinking age of 21 is not sufficiently related to interstate highway construction to justify so conditioning funds appropriated for that purpose."[157]

The majority took a much more expansive view when it came to applying these factors. As far as relevance was concerned, the majority concluded that "the condition imposed by Congress is directly related to one of the main purposes for which highway funds are expended--safe interstate travel."[158] Similarly, the majority took an expansive view of the voluntariness of the program involved. The Chief Justice emphasized that South Dakota was under no compulsion to change its drinking law. It was not being forced to adopt a federal program because it could simply refuse the federal funds. In this case, the money involved amounted to only 5% of the funds otherwise obtainable under specified highway grant programs. This did not strike the Court as a form of coercion. The majority, however, more broadly set forth its philosophy on this point by quoting at length from Steward Machine Co. v. Davis:[159]

> Every rebate from a tax when conditioned upon conduct is in some measure a temptation. But to hold that motive or temptation is equivalent to coercion is to involve the law in endless difficulties. The outcome of such a doctrine is the acceptance of a philosophical determination by which choice becomes impossible. Till now the law has been guided by robust common sense which assumes the freedom of the will as a working hypothesis in the solution of its problems.

As we shall see below, the use of conditions at the agency level raises a number of additional issues and problems. It is nevertheless possible to extract some general guidelines from this constitutional case that may have applicability at the agency level. First, it is safe to assume that the agency's constitution is its enabling act. It is the regulatory constitution, if you will, under which regulatory conditions and commitments are extended and agreed upon. Just as Congressional conditions are judged first in relation to the Constitutional power that presumably authorizes them, regulatory conditions and commitments must be judged in terms of the agency's own statutory (or "regulatory constitutional") power. The regulatory counterpart to an unconstitutional condition imposed by Congress is an ultra-vires condition imposed by an agency.

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[157] Id. at 2800.

[158] Id.

[159] Id. at 2798.

Second, the Dole case's requirement that conditions should be unambiguous and easily followed fully applies on the agency level. Such conditions are more easily administrated and enforced. While this requirement may seem obvious, it implies another aspect of conditions that is, perhaps, less obvious at the agency level. Implicit in the requirement of clarity at the Congressional level is the fact that the conditions used at the agency level be public. They should be accessible and thus, a known and knowable source of law. This, however, is not always the case. Many voluntary commitments at the FED are not found in the published orders of the Board. Moreover, the overall body of law created by the conditions that are in FED orders and thus, clearly on the books, may be so fact specific, that the underlying policy that these conditions represent is not at all clear. While it was very clear that Congress' policy was to raise the drinking age, such clarity often is lost in the high volume and fact specific nature of conditions at the agency level. As is set forth below, however, it may be advisable, from time to time, to examine the conditions in FED orders, summarize their basic thrust and policy and then make this summary available to the public.

Third, the Court's analysis in Dole suggests that conditions imposed at the agency level should not only be within the agency's power, but they should be reasonably related to issues raised in the application or petition before the agency. In other words, the facts of the case before the Board should give rise to the need for the condition attached or the commitment agreed upon. What is and what is not relevant should, perhaps, be read more narrowly at the agency level than at the Congressional level. If controversial questions of law or policy exist, conditions that seek to further that view of law or policy are, perhaps, best reserved for resolution at a more adversarial stage of the administrative process.

Finally,it may also be appropriate to take a less expansive view of what is and what is not voluntary when dealing with commitments at the agency level. This is due, in large part, to the fact that, unlike the State of South Dakota in the Dole case, individual applicants dealing with a federal agency have even less real bargaining power than the State. They were not represented in the legislature when Congress passed the law imposing these conditions. Moreover, as we shall see below, the nature of the FED's legal monopoly over the regulatory benefits that BHCA applicants must seek can seriously undermines the relative strength of the bargaining power relationships that exist between staff and applicants.

C. __Conditions and Commitments At The Agency Level--The Federal Reserve Board__.

Before examining in a specific manner the use of conditions and commitments at the FED, it is important, first, to review very briefly the conditioning power of the FED in general and some of the various kinds of cases in which conditions are important. We shall then examine five specific kinds of conditions or commitments in use at the FED.

(1). __Conditions--General FED Powers__. The use of conditions is clearly authorized by the Bank Holding Company Act. As Pauline Heller has noted in her treatise:

> Authority to approve or to deny reasonably implies authority to impose conditions.[160]

Specific and implied statutory authority for the Board's use of conditions is found throughout the Act.[161] Pursuant to this authority the FED has long used conditional orders to accomplish a variety of tasks in a variety of ways. Conditions may result from the application of general regulations,[162] the provisions of an individual order, or the extraction of a "voluntary" commitment from an applicant. Application approvals may be conditioned in a variety of contexts.

Approvals may be conditioned on shortening the life of a grandfather exemption;[163] they may be conditioned on limitations on various activities;[164] they may be conditioned to insure compliance with Community Reinvestment Act purposes;[165] approvals may also be conditioned on divestiture of interests that pose anticompetitive problems;[166] approvals often are conditioned on divestiture of impermissible activities;[167] and, what is often more controversial, approvals can also be the result of "voluntary commitments."[168]

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[160] P. Heller, Federal Bank Holding Company Law, § 7.08, p. 7-59, n.10.

[161] __Id__. See 12 U.S.C. §§ 1843(a)(2), (c)(8), (c)(9), (c)(12),(c)(13), (d); §§ 1844 (to carry out the provisions of, and prevent evasion of, the Bank Holding Company Act); and 12 M.S.C. § 1818(b)(to protect the safety and soundness of banking).

[162] Various regulatory provisions imposes conditions on approved activity. See e.g., 12 C.F.R. §§ 225.25(b)95)(leasing), (8) (assurance), (10)(courier), (17)(foreign exchange), (18)(futures commission merchant), (19)(futures and options on futures), (20)(tax planning and preparation), (22)(check guaranty), (23)(collection agency), (24)(credit bureau).

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[163] See e.g., Marine Bankcorp'n/Coast Mortgage, 58 Fed. Res. Bull. 505, 506 (1972)(land development).

[164] See, e.g., Mellon Nat'l Corp./Mellon Bank, 71 Fed. Res. Bull. 256 (1985)(tandem operations); Irving Bancorp/Irving Trust Calif., 71 Fed. Res. Bull. 173 (1985)(tandem operations); Security Pacific Corp./ Arizona Bancwest Corp. 72 Fed.Res.Bull. 800 (1986)(real estate activities authorized by State law); National Westminster Bank County Securities Corp., 72 Fed.Res.Bull. 584 (1986)(securities activities; Citicorp/Citicorp Gov't. Securities, 68 Fed.Res.Bull. 249 (1982).

[165] See, e.g., Ameritrust Corp./Cincinnati Trust Co., 66 Fed.Res.Bull. 238 (1980). After finding "serious violations' of the Community Reinvestment Act [the CRA requires the Board, in its evaluation of a BHC application, to assess the record of an applicant in meeting the credit needs of the entire community, including law--and moderate--income neighborhoods, consistent with safe and sound operation.]" The Board conditioned approval on Ameritrust's "promptly begin[ning] to maintain for a period of one year, or longer. . . a register of all inquiries and applications for mortgage and home improvement loans made in person at offices of Ameritrust in Cyuahoga County. . . " in addition to obtaining voluntary commitments for further action by Ameritrust.

[166] See, e.g., First City Bancorporation of Texas/Highland Village State Bank, 59 Fed.Res.Bull., 105 (1973). The Board voted to approve application subject to the condition that "Applicant divest itself of direct or indirect control, or control through one or more other persons, of any and all voting shares, in excess of 5 percent of the voting shares, of [two banks], such divestiture to be effected within six months after the effective date of this order unless such period is extended. . ." where applicant's retention of influence over the two banks would be "anticompetitive and not in the public interest."

[167] See, e.g., Depositors Corp./Firestone Financial Corp., 60 Fed.Res.Bull. 312 (1974)(tract of land); D.H.Baldwin/ Louisville Mortgage Service Co., 63 Fed.Res.Bull. 412 (1977)(real estate); Citicorp/First Federal S 7 L Ass'n of Chicago, 70 Fed.Res.Bull. 149(18'984)(real estate and insurance activities).

(2.) *Five Conditional Contexts*. These various substantive contexts in which conditions are imposed and commitments are extracted involve a number of variables. On a general level, these variables involve law, policy, and facts. Working with these variations, at least five ideal types of conditions/commitment emerge. There are, of course, innumerable variations on these five themes, but these contexts capture a good deal of the richness and complexity involved. They are set forth in order ranging from the least controversial use of the conditioning or commitment power to the most controversial.

(a). *The Perfect Condition*. The least controversial kind of condition or voluntary commitment is one that is fact specific, clearly within the legal power of the Board to impose, and one that furthers a previously articulated Board policy. Perhaps the most common kind of condition of this sort is one that involves safety and soundness factors. The Board must consider these factors under both Section 3 and Section 4 of the Act. In so doing, staff is often confronted with applications that may appear to be borderline when it comes to the applicant's capital adequacy or its debt to equity ratio. As a condition of approval, staff may very well request that the applicant agree to increase capital or reduce debt. This kind of condition is fully grounded in law, policy and fact. It enables the Board to carry out its regulatory duties without denying an otherwise grantable application. It enables the applicant to achieve its business goals in a safe manner. This kind of condition provides regulatory flexibility and enables the applicant's situation to be treated on an individual basis.[169]

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[168] See e.g., *Fleet Financial Group*/ Norstar Bancorp. Inc., 74 Fed.Res.Bull. 62, (1988). The Board, here approving the merger of BHC and the acquisition of banking and nonbanking subsidiaries relied on Fleet's commitment to divest some of its Norstar offices in certain markets on or prior to proposed merger, in order to mitigate the anti-competitive effect of the proposal. *Banc One Corp.*/American Fletcher Corp. , 73 Fed.Res.Bull. 124 (1987). Applicant made commitments in response to allegations by protestant that banks did not satisfy Community Reinvestment Act requirements. Applicant committed to:

"(1) Adopt expanded guidelines for CRA programs at subsidiary banks . . .;
(2) Develop marketing plans designed to increase loan penetration in low--and moderate--income neighborhoods;
(3) Develop a regulatory scheduled program designed to assure the adequate provision of information to subsidiary bank personnel regarding CRA requirements. . ;
(4) Develop programs to train personnel to utilize more effectively programs for community and economic development; and
(5) Establish and maintain an officer -level CRA committee reporting directly to Applicant's Board of Directors, in order to monitor and evaluate subsidiary bank CRA compliance.

Voluntary commitments usually are not published. *See, e.g.*, *Riley County Bancshares, Inc.*/Riley State Bank, 74 Fed.Res.Bull, 55 (1988). The Board approved formation of Bank Holding Company "[b]ased upon the facts of record, including commitments made by applicant and its principals in connection with this application. . . " The Board never articulated these commitments, however.

(b). The Policy Condition. A second general type of condition is one which, usually is fact specific, arguably within the agency's legal authority, but illustrative of a policy that is unarticulated in any formal sense or, perhaps, not widely know. This general context raises issues somewhat akin to those present in SEC v. Chenery.[170] In that case, the Supreme Court, *inter alia*, dealt with the question of whether the agency had to make policy through use of a rulemaking proceeding or whether it could formulate new policy in the context of an adjudication and, in effect, apply that new policy retroactively. A condition that represents a new policy or a policy that has not been formally articulated by the Board may fully be within the power of the Board to apply, but should the Board proceed in this manner?

The answer to this question may turn on how likely the issue is to arise in other cases or whether its imposition in this particular case was truly fact specific. If the condition does represent a policy that the Board consistently pursues in cases of this type, but nevertheless fails to adopt in the context of a rulemaking, it may very well represent a policy that has not been as fully developed or as carefully thought out as it should or could be. Thus, even if the policy is widely known, but nevertheless formally unarticulated, using conditions as the vehicle to implement this policy may deprive applicants (as well as the Board itself) of an opportunity to consider the full ramifications of the policy apart from the narrowing context of a specific case.[171] To the extent the policy is not only unarticulated, but unknown as well, it is subject to the same retroactivity problems in *Chenery*. Moreover, if this policy is furthered in the context of voluntary commitments and, thus, does not ever appear in the Board's published orders, it can be a source of "secret law."

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[169] For example, see 12 U.S.C. § 1818(b). See also, Texas Commerce Bancshares/American National Bank of Beaumont, 58 Fed.Res.Bull. 838 (1972)(The Board approved acquisition of shares of one bank subject to the condition that shares of a second bank acquired incident to the transaction be divested within a specified period of time. This condition was based on the Board's finding that acquisition of shares of both banks would have an anticompetitive effect on the banking market.); Security Pacific Corp/Financial Services Corp., 73 Fed.Res.Bull. 381 (1987)(As is the case with any action implicating the Douglas Amendment, the Board ultimately conditions its approval upon the approval of the state banking supervisor of the state in which the bank sought to be acquired is located. In this case, approval from the Oregon Banking Supervisor was required).

[170] 332 U.S. 194 (1947).

Examples of policy conditions usually involve questions concerning the Board's legal authority as well. These are discussed below.

(c). *Legal Authority Conditions*. Conditions involving legal authority involve issues in which the Board's regulatory authority is at best unclear and, at worst, non-existent. It often will embody a known Board policy, but one that has not been formally articulated and it may or may not be fact specific.

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[171] *See, e.g.*, *First Bancorporation v. Board of Governors*, 728 F.2d 434 (10th Cir. 1984)(The court overturned a Board order conditioning approval of section 4 acquisition of industrial loan company on applicant's agreement not to engage in NOW activity through this company, even though it was permissible under state law. The Board additionally subjected such activity already engaged in by Applicant's subsidiaries to banking regulations. The court characterized the Board's action as an impermissible attempt to create legislative policy by adjudicative order.

According to the court, NOW activity cannot be considered "banking" as a matter of law, and thus cannot be subject to banking regulations. The court also found the Board's attempt to apply these conditions to Applicant's previously acquired loan company was particularly egregious because it made absolutely no conclusions and its order contained no adjudicative facts having any relevance to that company. Finally, the court recognized the impropriety of the Board's subsequent use of the order as precedent to impose similar conditions on other applicants engaged in NOW activity, characterizing the Board's original order as "merely a vehicle by which a general policy would be changed." *Id*. at p. 437.

For example, the Board has long been troubled by what it considers to be the financial risks to a bank holding company system associated with real estate investment and development activities conducted by subsidiary banks. To deal with this problem the Board often conditions its approval of BHC applications seeking to acquire state chartered banks on the grounds that this newly acquired state bank will not, in fact, engage in real estate development activities.

The problem with such conditions is twofold: (1) In a number of states--for example, Washington, California, Ohio and New York--real estate development as well other activities the Board might frown upon are, in fact, authorized; (2) the Board has agreed that it does not have any legal authority to regulate activities of state chartered banks.[172] Arguably, conditions of this sort inappropriately extend federal jurisdiction into the state's domain.

These kinds of conditions, nevertheless, have been particularly common in the real estate development and insurance areas. The Board often insists on voluntary commitments in these areas on behalf of both state chartered bank subsidiaries of Bank Holding Companies and subsidiaries of those banks. In Equimark/ Liberty Bank,[173] for example, Equimark sought to acquire a nonbanking subsidiary of a state chartered bank which was authorized to engage in real estate investment and development activities. Another subsidiary of the same bank was authorized to engage in general insurance activities. The Board obtained assurances from Equimark that in both cases the activities would be discontinued and either divested or dissolved within a predetermined amount of time.

In this and other cases like it, the Board often argues that such activities are impermissible because it has not determined that real estate investment and development activity is closely related to banking under section 4(c)(8) of the Act, and thus this activity is not permissible for bank holding companies under Section 4 of the Act.[174] Recently, with regard to Section 3 cases, the Board has taken a different approach. It has proposed a regulation to the effect that real estate development activities, if conducted, directly or indirectly by a state bank subsidiary of a bank holding company would, per se, constitute an unsafe and unsound banking practice warranting the Board's denial of any such application under Section 3 of the BHCA.[175]

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[172] See Merchants National Corporation, Indianapolis, Indiana (Sept. 10, 1987), Fed.Res.Bull. 876 (Nov. 1987).

[173] 74 Fed.Res.Bull. 61 (1988).

[174] See, e.g., Security Pacific Corp./ Arizona Bancwest Corp. 72 Fed.Res.Bull. 801 (1986). The Board conditioned approval on Applicant's divestiture of real estate development activity engaged in by subsidiary of bank sought to be acquired even though this activity was authorized for state banks

This resort to rulemaking on the part of the Board makes good sense, particularly when the Board's legal authority to implement such a policy is clear. It is also a sound approach to take when the Board thinks its authority is clear, but its policy is not. Yet, the resort to rulemaking cannot be considered a cure-all for the kinds of commitment problems raised by this example. Even if we assume that such a policy is within the statutory power of the Board to implement, opponents persuasively argue that a per se rule runs counter to the statute's requirement that Section 3 criteria be specifically considered "in every case." The Act would seem to mandate an individual determination of the financial and managerial factors of the particular applicant and the particular proposed subsidiary bank.[176]

In short, resort to the Board's rulemaking power may not be an appropriate way to resolve a controversial policy question when what is proposed is a per se rule for all cases. A per se rule may not be possible; nor may a condition be imposed that does not relate specifically to the financial condition of the individual applicants in this case. The individualized nature of the process, as mandated by the statute, may in fact, require that any conditions imposed or commitments extracted be fact

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operating under Arizona law. Applicant was also required to divest similar interests of the subsidiary of a state bank it had previously acquired which was authorized to engage in such activities under California banking law; D.H.Baldwin/ Louisville Mortgage Service Co., 63 Fed.Res.Bull. 412 (1977). Approval of application was conditioned upon divestiture of real estate development activity of a subsidiary of the mortgage company D.H. Baldwin sought to acquire under section 4 of the Act. The Board made no determination that the activity in this particular instance constituted an "unsafe and unsound" practice.

[175] See Docket No. R-0616, 52 Fed. Reg. 42301 (November 4, 1987).

[176] Letter from Wells Fargo & Co. to William W. Wiles, Sec. Borad of Governors of Federal Reserve System (Dec. 3, 1987)(Comments in response to proposed regulation, Docket No. R-0616, 52 Fed.Reg. 42301 (Nov. 4, 1987).

specific and depend upon the financial soundness of the applicant involved. To use certain applicants simply as policy implementation vehicles is, perhaps, to stretch the Board's powers too far. To try to sidestep this problem with a per se rule may deprive the applicant of a statutorily mandated, fact-specific determination.

Nevertheless it should be emphasized that the resort to rulemaking by the Board is preferable to a policy condition that is based on an unknown or formally unarticulated, controversial Board policy. It provides all affected applicants and potentially affected applicants with an opportunity to participate. More importantly, it enables the Board itself to think through the long-term policy implications of its positions. This suggests a fourth kind of condition.

(d). Prospective Conditions. Closely related to policy and legal authority conditions are prospective conditions. A prospective condition is one in which the condition imposed or the commitment extracted embodies a policy that arguably is within the legal authority of the Board to enact, may or may not be formally articulated, but does not necessarily apply directly to the facts of the application involved. The applicant is purely a policy vehicle, if you will, in that it must agree to conditions regarding future activities in which it presently has no intention to engage.

Real-estate development commitments as well as insurance activities commitments are sometimes extracted even though the applicant has no present intention of engaging in these activities.[177] This may be a way around the argument that the statute bans per se rules of this sort, but it is, in its own way, another kind of per se rule. The agency makes this activity impossible in the future even though it is not a part of the present case. From a bargaining point of view, the strength of the Board's bargaining position is particularly strong, because the applicant is usually not willing to fight for something it does not plan to use.

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[177] See, e.g., Yellowstone Holding Company/Yellowstone Bank, 66 Fed.Res.Bull. 250 (1980). The Board issued an order approving the formation of a Bank Holding Company under section 3 of the Act. Approval was conditioned on Applicant's "commitment to comply promptly with any new policy adopted by the Board concerning the disposition of income from the sale of credit life, health or accident insurance in connection with loans made by the bank." p.251. Although the Applicant was not presently engaging in such activity, nor did it appear to have any interest in doing so, the Board effectively foreclosed any possibility of engaging in it in the future in any manner other than that prescribed by the Board according to general policy, but not necessarily related to Applicant's specific characteristics.

(e). Null and Void Conditions. Finally, perhaps the most controversial condition would be one that was not grounded in law or an articulated policy of the Board and was not closely related to the facts of the particular applicant's case. This clearly would be an ultra-vires condition.[178]

These types of conditions may be summarized as follows:

Condition Types	**Law**	**Policy**	**Fact-Specific**
Perfect	+	+	+
Policy	+	-	+ or -
Legal Authority	-	+ or -	+ or -
Prospective	+	+ or -	-
Null	-	-	-

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[178] See, e.g., Securities Industry Association v. Board of Governors of the Federal Reserve System, Fed. Securities Law Reports ¶ 93615 (2d Cir. 1988). The Court reviewed a condition imposed by the Board in an order approving applications to engage in certain limited securities activities under the Glass-Steagall Act. The condition limited underwriting activities of applicants based on a percentage "market share" analysis. The court, finding this quantitative limitation to be unreasonable and unsupported by the law as evidenced by past interpretations of the Act and legislative history, struck down the condition. (for the original order, see, Citicorp/Citicorp Securities, Inc., J.P. Morgan & Co. Inc./ J.P. Morgan Municipal Finance Inc., Bankers Trust New York Corporation/ BT Securities Corporation, 73 Fed.Res.Bull. 473 (1987); First Bancorporation v. Board of Governors, 728 F.2d 434 (10th Cir. 1984), U.S. Dkt No. 84-1274 (court struck down condition imposed by the Board, finding both that it was based on an incorrect interpretation of the law, and that it was ultra vires).

D. Regulatory Conditions , Voluntary Commitments and the Limits of the Bargaining Model As Applied to the Administrative Process.

As a recent Board report has noted, BHCA applications "are often responsive to suggestions from the Federal Reserve for improvements in their condition or for changes to their proposals in order to limit adverse effects and thereby increase the chances for approval."[179] The process of negotiation that occurs between applicants and Federal Reserve Board Staff is best described by the bargaining model of the administrative process, briefly set forth above.[180] There is no neutral third party adjudicator to resolve disputes at this stage of the process. The issues that arise and the resolution that is reached is largely between the applicant and the staff. As we have seen, an integral part of this bargaining process is the FED's use of conditions and the extraction of voluntary commitments. It is not the purpose of this report to, in any way, second guess the substantive wisdom of the results that these processes reach. This report is not concerned with the consequences of the Board's decisions, but the processes by which they are made. It is for this reason that it is important to examine the limits of the bargaining model as applied to this kind of administrative process as well as the procedural consequences of its application.

(1). The Limits of the Bargaining Model. A bargaining model is based on the assumption that the decision reached between two parties is a joint decision. This, in turn, assumes that each party has something to gain and to give in the process of making compromises to one another. For this process to work, neither party can have overwhelming bargaining superiority. In the regulatory process, however, the FED has a legal monopoly over the benefits that the applicants seek. Though a denial of an application cannot be arbitrary, judicial review generally operates as a check only in the most extreme of cases. The agency's discretion is not easily constrained. As a result, the bargaining process takes on great importance. An applicant, of course, would rather have an approval than a denial, and the Board has the power to do both. Because applicants do not want to be denied, they are particularly susceptible to suggestions by the Board that they make certain commitments or accept various conditions. Even if they disagree with the legality or need for these conditions and commitments, they usually are preferable to a denial of their application. Something is better than nothing.

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[179] See note 97, supra at p. B-6.

[180] See text at notes _____, supra.

This is not to suggest or to argue that the Board desires to misuse its power or improperly manipulates applicants. The regulatory negotiations that take place and the kind of unequal bargaining power that results is a natural by-product of the regulatory framework that Congress itself provided when it passed the Bank Holding Company Act. The use of conditions and commitments is not the result of a power grab on the part of the Board. The use of these regulatory tools is inherent in an applications process which, by definition, requires one-on-one decision-making process.

Moreover, this kind of regulatory process has many advantages. The Board can be more effective from a regulatory point of view by pinpointing its concerns and, through conditions or commitments, precisely tailor its regulation to meet its concerns. From the point of view of the applicant, this bargaining or negotiation approach also has advantages. Rather than risk outright denial of its applications, bargaining allows individual applicants at least to achieve some if not most of its business goals. In addition, applicants usually are in a great hurry to obtain approvals. The nature of the business transactions involved often necessitate prompt Board action. It is in the applicant's interest to have access to a bargaining process so that it can simultaneously negotiate a regulatory result that it can live with and take advantage of the business opportunities that come its way. In short, the nature of the regulatory system established by the BHCA plus the regulatory goals of the Board coupled with the business needs and consequent demands for prompt, focused action on the part of applicants make a bargaining approach to application decisions virtually inevitable.

The limits of this approach, however, are clearly apparent when it is applied through use of so-called "voluntary commitments." This is so because it is in such contexts that the relatively unequal bargaining strength of the negotiating parties is most apparent. In cases where the commitment asked is fact specific, fully within the Board's power and directly related to an articulated policy, an opportunity to make such a commitment is a definite plus for the applicant. It can expedite the application, mitigate regulatory concerns on the part of the Board, and allow the transaction it proposed to succeed. But as we move away from the "perfect" condition or commitment, the "voluntariness" of the commitments made become less and less likely. This, as we shall see, can have a number of unfortunate regulatory consequences.

(2). The Regulatory Consequences of Providing or Extracting Voluntary Commitments. When applicants are faced with a commitment not to engage in activities they believe are fully allowed under the law, or they are asked to forego action that, in effect, represents an unarticulated or new policy, they may very well agree. That agreement, however, is likely to be based on a "lesser of two evils" kind of reasoning. Rather than forego entirely the acquisition it proposes, the applicant is often willing to chose a more modified form of approval.

One might argue, not unlike Chief Justice Rhenquist in South Dakota v. Dole, that this choice nevertheless is "voluntarily" made. In reality, however, the applicant has no alternative. There is no regulatory substitute for the authorization it seeks. The Board has a legal monopoly and though we may assume that it is carrying out its regulatory duties in as conscientious and effective a manner as possible, the very voluntary nature of the commitments it obtains effectively prevents the conversion of the bargaining model into an adjudicatory model. Since the applicant has, in effect, waived its legal rights, such decisions are difficult to challenge in court. If the commitment imposed is in the form of a condition, and it is in the final order, there is, at least, the theoretic possibility of challenging an ultra-vires condition in court. The threat of judicial review can thus help add some balance to the bargaining relationship.

But even if we assume that the commitment made truly is voluntary, there are several regulatory consequences that follow, particularly when issues of law and policy are involved. The reality of such a process is that it may give an inordinate amount of policy making power to the staff involved. Such policy making in the context of individual cases involving voluntary commitments may remove longer-term policy considerations from the planning process and effectively exclude members of the Board itself from a major decision-making role. The following example is illustrative of this problem.

On February 3, 1987, a hearing was held involving Section 20 of the BHCA before the Board of Governors of the FED. This hearing considered applications of Citicorp, J.P. Morgan and Co., Inc. and Bankers Trust New York Corporation to underwrite and deal in municipal revenue bonds, mortgage--related securities, consumer--receivable--related securities and commercial paper. The Board considered, among other things, whether a bank affiliate was "engaged principally" in bank--ineligible underwriting activities. During the negotiation phase of these proceedings, each of the bank holding companies had "voluntarily" consented to market-share limitations while protesting that they were not legally required or economically constructive. Their "voluntary" nature had the effect of making the policy decisions inherent in these commitments appear as a fait accompli when they ultimately were presented to the Board.

The following excerpt thus highlights the fact that a voluntary commitment certainly may discourage or, in some cases, effectively deprive the Board of an opportunity to examine fully the legal and policy implications of staff positions embodied in voluntary commitments.

VICE CHAIRMAN JOHNSON: You've also proposed market share tests on your activities as well, and I take it that you did that to make it clear that even if you used some volume requirements, volume measure of activity in the affiliate, you would not violate some sort of market share test. I think you've all proposed about three percent.

MR. WEATHERSTONE: Governor Johnson, I think we did that reluctantly because we think the market share test has very little to do with "principally engaged."

VICE CHAIRMAN JOHNSON: I agree with that, but you proposed it. I'm just asking.

MR. WEATHERSTONE: We proposed it, yes, but with some reluctance. We think it serves very little purpose, but we did propose it. We think it's anti-competitive, and I think the Justice Department has a view about that as well.

VICE CHAIRMAN JOHNSON: Why did you propose it?

MR. WEATHERSTONE: To expedite the applications.

GOVERNOR ANGELL: So, in other words, you thought we might be more apt to approve it if that was in, but you see no justification in terms of economic or legal reasons for having it in?

MR. WEATHERSTONE: We would rather not have it.

GOVERNOR ANGELL: You see no legal or economic justification for it.

MR. THEOBALD: We take exception.

CHAIRMAN VOLCKER: The relevant question may not be whether it's economic, but whether it's legal.

The Board ultimately accepted these market share limitations. They were, however, overturned by the Court of Appeals.[181]

Quite apart from the relative roles of staff and the Board when it comes to policymaking, another consequence of voluntary commitments of this sort is that they can often become a source of "secret law." Unlike the SIA case above, many voluntary commitments do not appear in the Board's final order. They are not likely to be challenged in court, and they are not likely to be widely know to the public. Many times the fact specific, confidential nature of these commitments requires that they be "privatized." But even fact-specific commitments made in a number of cases are likely, overtime, to add up to particular policy that may or may not have been articulated by the Board. This, of course, is a particular problem if the voluntary commitment is not just fact specific, but based on a policy that is controversial and formally unarticulated.

In short, commitments play a valuable fine-tuning, regulatory role, but the further the commitment strays from the individual facts of a particular applicant and/or the more controversial the policy and legal positions of the staff that request them, the less voluntary these commitments are likely to be. In such situations, it is more likely that the Board's power will remain relatively unchecked and run the risk of being overextended. To retain the very positive and useful features of the bargaining approach to the applications process established by the Bank Holding Company Act, and at the same time limit the potential for abuse that may exist, it is necessary to consider ways of equalizing the bargaining power of the applicants involved as well as attempting to discern just when the bargaining model is appropriate and when it is not.

(3). Equalizing Bargaining Positions. The power exercised by the Board in these cases is, as we have noted, very much a by-product of the regulatory scheme set forth by Congress. It also is, by and large, a good way to proceed in the usual, routine case. But when voluntary commitments are extracted in cases in which law and policy are unclear and the issues controversial, such commitments are not likely to be voluntary. The imposition of conditions that interpret the Board's legal authority very expansively and/or take controversial policy positions are somewhat less of a problem because they are more easily challenged in court. This ability for a realistic appeal to a third party decision-maker adds to the bargaining power of the applicant. They can legitimately invoke the perspective of those outside of the staff. To the extent these "threats" are valid, they can moderate the commitments or conditions requested. If they are not moderated, a court may act. One way of equalizing bargaining power between staff and applicant is to encourage judicial review of "voluntary commitments." This would at least militate against the use of commitments that arguably are ultra vires.

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[181] SIA v. Federal Reserve Board, Federal Securities Law Reports, ¶ 93615, (2nd.Cir. 1988).

Perhaps this can be done in two ways: (1) when legal issues are in contention, the Board should, to the extent possible, refrain from extracting or accepting voluntary commitments. But if they occur, they should be part of the Board's order and, to the extent possible, converted into conditions which are then appealable to a court. That is to say, it should be assumed that commitments that involve serious questions of law and/or policy are made to facilitate the processing of an initial Application. Applicants do not necessarily concede that these commitments are either permitted or required under the Bank Holding Company Act and thereby, should be able to reserve the right to seek modification or termination of these commitments in court or in another application proceeding. This can be done if these commitments can, where the record provides, be converted into conditions.

Indeed, another way of attempting to equalize the bargaining relationships between staff and applicants is to encourage the Board of Governors to look closely at "voluntary commitments" of this type. That is to say, the Board should be encouraged to view these commitments not as waivers, but as issues worthy of their careful consideration.

In addition to the involvement of third parties such as courts or the Board of Governors itself, it is important to recognize that certain kinds of issues are more appropriate for adversarial dispute resolution models and less appropriate for bargaining models. This is particularly the case when legal issues are in contention. These questions should be decided in Court and not be part of the bargaining process. It also would seem to follow that where issues of policy are in contention, adjudication and especially rulemaking are the appropriate procedural responses. When law and policy are clear, however, and only the relative financial strength of the applicant is in contention, a bargaining model is much more appropriate. The bargaining strength of the applicant is enhanced if it is financially strong. It is weakened if it is not financially sound. Given the safety and soundness considerations of the Act, this is as it should be.

Finally, another means of ensuring more equal bargaining power is use of the 91-day rule. Perceptions concerning such variables as economic conditions can vary leading the Board to request additional information and thereby tolling the 91-day period. This is often necessary, but there can be some confusion concerning when a file is finally informationally complete and when it is not. To ensure that the informational and bargaining phases of the process are separate and distinct, as well as to avoid any confusion concerning the running of the 91-day period, the Board's regulations should require an explicit finding by the Board when a file is informationally complete and ready for consideration. This is particularly needed in the small minority of cases in which varying perceptions concerning the merits of an application as well as a rapidly changing economic setting may, on occasion, create some confusion as the when the 91-day rule is in effect.

In short, problems emerge when the bargaining approach to regulation is applied to issues more appropriate for adjudication or rulemaking. Some of this is the inevitable result of a regulatory process like that of the BHCA. Some is the result of good faith differences over the law and policy between applicants, staff and, in some cases, the Board of Governors itself. But much is due to both the perception and the reality of unequal bargaining power.

It would be an overreaction to these problems to discourage significantly the flexibility and fine tuning capabilities that the use of conditions and commitments make possible. It would be equally wrong, however, to assume that a true bargaining model can apply in a regulatory context such as this or that all commitments are truly "voluntary." An appropriate balance between the flexibility of a bargaining process and the potential abuse of the legal monopoly involved may best be achieved by attempting to equalize the bargaining power of staff and applicants and counselling regulatory restraint on the part of the Board when issues of law and policy are seriously in contention.

PART V

Summary and Tentative Draft Recommendations

This study has concentrated on the FED's implementation of its regulatory duties under the BHCA. It has divided the FED's decision-making procedures into three analytically distinct phases: (1) the informational phase, (2) the bargaining phase, and (3) the adjuciatory phase. Recommendations are suggested for each phase of these proceedings.

I. The Informational Phase of the Decision-making Process.

The informational phase of these proceedings occurs at the filing of a BHCA application and, many times, even before filing. This phase is concerned with compiling and providing to the FED the information necessary to make a decision on the merits of the application. The overall fairness of these proceedings can be enhanced if the informational stage of the proceedings is kept as distinct as possible from the more judgmental phases of the process that follow. This may be accomplished by further clarification of the Board's 91-day rule.

The 91-day rule requires the Board to issues a decision within that time period. It does not begin running until the applicant's file is informationally complete. There often is, on occasion, some confusion as to when this occurs, particularly in difficult cases involving changing economic circumstances. Despite the very useful attempts to clarify the 91-day rule set forth in the Board's regulations, the FED should ensure in its regulations that it will make an explicit finding when a file is informationally complete, particularly in those cases in which the 91-day rule may have been tolled.

II. The Bargaining Phase of the FED's Decision-making Process.

The nature of the regulatory process established by Congress under the BHCA encourages a bargaining, negotiated approach to decision-making on the part of applicants and the FED. The one-on-one nature of an applications process, the nature of the business transactions involved, the consequent desire of applicants to close their deals as quickly as possible and the ability of the FED to tailor its regulatory decisions to the specific applicant before it, are all factors that encourage the use of various kinds of conditional orders. Many of these appear on the face of the Board's final order and are fully subject to judicial review. Other orders, however, are the result of so-called "voluntary" commitments on the part of the applicant involved. A commitment differs from a condition because it is voluntarily made, does not usually appear on the face of the Board's order, and usually is not subject either to judicial review or serious consideration by the Board of Governors.

This Report stresses that the use of conditions and commitments are inherent in the kind of applications processes established by Congress in the BHCA. They are important regulatory tools that, for the most part, add flexibility to and encourage efficiency in the consideration of applications pursuant to this Act. Conditions and commitments are the currency of the negotiation decision-making model that describes this process. The finetuning capability they provide to the agency means that regulation can be individually tailored. They thus provide for a wide range of regulatory choices between unconditional approval and automatic denial.

Despite these advantages, there are some contexts in which conditions should be applied cautiously and the use of voluntary commitments should be avoided. This Report has identified five kinds of conditional orders: (1) Perfect conditions; (2) Policy conditions; (3) Legal authority conditions; (4) Prospective conditions; and (5) Null conditions. In general, conditions should be unambiguous, reasonably related to an expressed Board policy and fully within the Board's powers. Because conditions are subject to judicial review, however, the imposition of conditions that depart from this norm can at least be tested in court. This usually is not the case with voluntary commitments. This Report suggests that voluntary commitments should not be exacted when they involve questionable extensions of the Board's legal authority. They should also be cautiously used when they represent policies that are controversial, unknown or formally unarticulated. Commitments that involve questionable or controversial interpretations of the Board's legal authority or policy are not likely to be truly voluntary. On the one hand, the inequality built into the regulatory bargaining process can inappropriately encourage such commitments. On the other hand, the desire on the part of the applicants themselves to expedite their application can also encourage such commitments. To the extent possible, when there are serious differences over law and/or policy, commitments that seek to satisfy these concerns should be converted into conditions, and made an appealable part of the Board's order.

In summary, this Report recognizes that it is not at all easy to determine what kinds of commitments fall within the various categories set forth in this report. This Report suggests, however, that a number of steps to help equalize the bargaining relationship that exists between applicants and staff. First, this Report recommends that voluntary commitments that raise serious legal and policy issues should, to the greatest extent possible, be converted into conditions and made part of the Board's final order, subject to judicial review. Second, this Report encourages the Governors of the Federal Reserve Board not to treat all voluntary commitments--particularly those raising questions of legal authority and/or policy--as a *fait accompli*. They should be considered as issues worthy of further exploration. Third, the running and tolling of the 91-day rule should be made as clear as possible, particularly in those cases in which new information and changing circumstances may be interpreted differently by the Board and its applicants. A finding indicating that a file is or is not informationally complete could, in such cases, be useful. Fourth, the Board and its staff should be encouraged to make both the conditions they impose and the commitments they request as fact and applicant specific as possible. Finally, the Board should also be encouraged to make the commitments issued as public and as accessible as possible. To satisfy confidentiality, it may be necessary, from time to time, to summarize the overall policy thrust of these commitments and to publish these summaries in the Federal Register. In this regard, it might also be useful to process, on an accelerated basis, any FOIA requests made by potential applicants to the Board seeking the transmittal letters in which most of these voluntary commitments are found.

III. The Adjudicatory Phase of the FED's Decision-making Process.

This report has also examined the FED's use of adjudicatory hearing procedures to resolve disputes under Section 3 and Section 4 of the Act. For the most part, the FED's implementation of the procedures mandated by statute as well as those provided in its regulations has evolved to an ultimately satisfactory state. The Board has struck a proper balance between the procedural rights of applicants and protestants. It has been responsive to claims for additional procedure, particularly in unusually difficult cases.

Section 3 of the Bank Holding Company Act, however, calls for a full-blown adjudicatory hearing if an application is denied by a state official or the Comptroller of Currency within thirty days of its receipt. This provision is rarely invoked and is easily circumvented. There are few instances in which this kind of hearing is necessary. The FED has wisely used its discretionary powers to provide for more elaborate hearings when necessary. The statute should be amended to make the full-blown adjudicatory hearings mandated by Section 3 of the BHCA discretionary with the Board.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-4

DEFERRED TAXATION OF GAINS REALIZED UPON DIVESTITURE OF PROPERTY TO AVOID CONFLICTS OF INTEREST

by

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I. Introduction

In accordance with the requirements of the Ethics in Government Act, 18 U.S.C. §208, many presidential appointees are required to divest themselves of property to satisfy conflict of interest requirements. In many cases, such divestitures would result in financial losses as a result of increased tax burdens resulting from the recognition of taxable gain. It is believed that these burdens may provide a disincentive to those individuals who would otherwise accept a federal appointment.

II. The Statutory Requirements

A. *Tax Deferred Gains and Losses.* The basic point of reference is Section 1031 of the Internal Revenue Code of 1986. It provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property "of like kind" which is to be held either for productive use in a trade or business or for investment. The statute requires a "roll-over" within 180 days, and provides for a carry-over cost basis from the sold property to the newly-acquired property. By its terms, the statute does not apply to stocks, bonds, or notes, or other securities or evidences of indebtedness or interest. *See* Section 1031(a)(2). Hence, any amendment to the Internal Revenue Code to deal with divestitures will have to modify this statute to provide for an exception to the exclusion for stocks and bonds.

B. *Eligible Persons.* The class of persons eligible for deferral should generally conform to the class subject to the Ethics in Government Act. For example, the eligible persons should generally include presidential appointees who are subject to Senate confirmation, equivalent-level White House officials, and persons already serving in the executive branch whenever an independent, higher authority (*e.g.*, the designated agency ethics officer or head of the agency for agency employees; the Director of the Office of Government Ethics in the case of an agency head) determines that a potential conflict of interest cannot be resolved by a remedy other than divestiture without substantially impairing the ability of the officer or employee to carry out the duties of his or her office. The determination that divestiture is required should be in writing and made available to the public. Since the divestiture requirements apply to the holdings of the government officials themselves, their spouses, dependent children, trusts and certain other entities, such persons occupying federal positions covered by the Act and those persons related to the affected federal appointee should be eligible for tax-deferred divestitures.

C. *Certification.* There are a number of federal appointees who can solve their "conflicts" problems without resorting to divestiture. As a general matter, divestiture is not required by federal law. Although some government agencies require divestitures and prohibit certain holdings (*e.g.*, energy investments, defense contractor investments), the Office of Government Ethics reported in 1982 that recusals, waivers, qualified trusts and other remedies usually can cure potential conflicts of interest. For example, there are a number of cases in which compliance could be assured without a substantive limitation of the normal duties of office, including cases where the holding in question could either: (1) be placed in a qualified diversified trust; (2) meet the waiver guidelines of 18 U.S.C. §208(b) promulgated by the Office of Government Ethics;[1] or (3) require a recusal, the effect of which would not be a continuing generic abstention which significantly impairs the ability of the official to perform in his position. It has been suggested that the qualified diversified trust and the waiver are not practical ways to deal with the conflicts problem because the trust is costly to establish and the waiver delays executive decision-making. Accordingly, the tax-deferred divestiture provision should be available only for those persons for whom divestiture is determined by the Director of the Office of Government Ethics to be appropriate to assure compliance with 18 U.S.C. §208 and other conflict of interest statutes and regulations. In order to limit the availability of deferral, the Director should not make such a determination in any case in which compliance could be assured, other than by divestiture, without substantive limitation of the normal duties of the appointee's office. If divestiture is required, it should apply to the entire category of tainted assets, such as energy stocks or defense industry stocks.

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[1] The waiver guidelines embody a three-part test: (1) the total value of each such holding attributable to the interested parties represents less than 0.5% of the total value of the official's interest in property (and does not exceed $50,000); (2) such holding is not in an entity having substantial activities in the official's primary area of responsibility; and (3) if such holdings is in a trust, it is a diversified holding (less than 20% of portfolio value of such trust).

D. *Mandatory Operation.* Once an appointee is determined to be subject to divestiture with respect to a class of investment (*e.g.*, energy stocks), the appointee subject to divestiture should not be able to claim losses on property that has declined in value below the level of his cost basis. If such were not the case, an appointee might be able to exploit the occasion of entering federal service to obtain the benefit of losses which he may not otherwise have chosen to recognize. If he also has gain property subject to divestiture, the gains could be netted out against the losses, thereby permanently eliminating tax. The tax-deferral provisions should be mandatory for all covered officials in order to avoid such individualized tax-motivated transactions. In this way, the relief measure would apply across the board to all property subject to divestiture and postpone all tax consequences that would otherwise occur as a result of divestiture.

E. *The Reinvestment Vehicle.* The proposal limits the tax deferral to reinvestment in a regulated investment company which has an "approved well-diversified portfolio." The term "approved well-diversified portfolio" is defined as "the portfolio of a regulated investment company which, pursuant to regulations to be recommended by the Director of the Office of Government Ethics and promulgated by the Office of Personnel Management, has been approved by such Director as meeting the standards for well-diversified portfolios as contained in regulations issued under the Ethics in Government Act."

This standard is somewhat analogous to various provisions in the Code of Federal Regulations defining financial interests that are exempted from the prohibition of 18 U.S.C. §208(a), as being too remote or too inconsequential to affect the integrity of an employee's services in a matter so as to require disqualification. The regulations governing the Department of Justice (28 C.F.R. §45.735-5) are representative of the standard. See also 18 U.S.C. §208(b). They define remote financial interest as --

> The stock, bond, or policy holdings of an employee in a mutual fund, investment company, bank or insurance company which owns an interest in an entity involved in the matter, provided that in the case of a mutual fund, investment company or bank the fair value of such stock or bond holding does not exceed 1 percent of the value of the reported assets of the mutual fund investment company or bank.

The foregoing standard relates to disqualification (recusal) arising from private financial interests. For most government officials, investment in such a vehicle would solve conflict of interest problems and enable the appointee to make a personal investment decision before entering government service.

There may be situations, however, in which investments in a mutual fund or particular funds would not solve the conflict of interest problems of an appointee. For example, a high-level official in the Securities and Exchange Commission with authority over mutual fund regulation may not be able to invest in a mutual fund without a substantive limitation of the normal duties of office. For such individuals, the approved well-diversified portfolio could be an account maintained by the government which would guarantee a prescribed rate of interest and appreciation. With respect to such employees, the government need not actually maintain the fund but can simply dispose of all of the assets and retain the cash proceeds and pay the income to the officials from the general revenues.

Upon leaving government service, the officeholder should be allowed to roll over the cash proceeds in his account into a new investment as a condition for further postponement of taxation until those assets are sold. The 60-day I.R.A. roll-over period seems to be an appropriate time frame to make such a reinvestment. One issue that should be addressed is whether the official, during his government service, should be permitted to draw down his investment account and bear pro rata immediate taxation. The reduced income from government service suggests that this option be given to the federal officeholder in exchange for relinquishment of the tax deferral. The imposition of tax on a withdrawal would follow normal tax rules and would put the official in the same position that he would have been had he sold the stock or securities at the commencement of his government service.

F. *Revenue Impact.* The Conference believes that the narrow class of persons (and their dependents) subject to divestiture suggests that the revenue impact of the recommendation will be minimal. Even in a presidential transition year, the prospective and present government officials eligible for tax deferral would be less than 1,000 persons and in other years the number would be much smaller.

H. *Treasury Objections.* When the proposal was originally circulated within the Executive Branch in the early 1980s , the Treasury expressed opposition. In the Treasury's view, the proposal could not be distinguished from other situations in which taxpayers are compelled by personal circumstances to sell stock (*e.g.*, to pay medical bills or to pay business losses). But in those situations, the taxpayer is actually "cashing in" his investment. Here, on the other hand, a narrowly defined class of persons is simply changing the form of their investment pending the completion of their government service. Moreover, the fact that acceptance of a federal appointment is a voluntary act should not mean that it must be accompanied by onerous tax consequences.

Second, the Treasury argued that the proposal would create an undesirable incentive to enter government service for the special tax benefits that would be available. While there are many considerations that prompt people to accept federal appointment, it is hard to imagine that the proposal would improperly encourage people to enter government service. The narrow scope of affected persons is a sufficient rebuttal to the charge that enactment would make it more difficult to resist broader rules that would permit most taxpayers to roll over investments.

Third, in 1982, the Treasury argued that the 20% capital gains rate was sufficiently low so as not to be a burden for prospective nominees. But the capital gains preference has now been eliminated for tax years after 1987. Thus, the tax burdens arising from divestiture are now substantially greater than they were six years ago.

Finally, the Treasury expressed concern about the equity of a proposal that would provide significant financial benefits to the few appointees who are faced with a potential tax on capital gains. At the same time, no tax benefits are available to career government employees and those appointees who do not have substantial investment in stock. The benefits, however, are temporary in nature. All that the proposal seeks to accomplish is to permit a potential appointee to make a decision with respect to federal service without regard to the negative tax consequences that would otherwise result. Consideration of federal service should be a tax neutral decision. The fact that the proposal addresses a narrow concern, rather than bestowing largesse upon the entire civil service, is an argument in favor of its enactment rather than evidence that it is inequitable.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-5

BREAKING THE SETTLEMENT ICE: THE USE OF SETTLEMENT JUDGES IN ADMINISTRATIVE PROCEEDINGS

by

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INTRODUCTION

Litigation is sufficiently expensive and distasteful to parties that they generally favor settlement as an idea. However, settlement negotiations before litigation or between opposing counsel in litigation are frequently unsuccessful, and in many cases never even begin. Litigating lawyers and judges know that many such failures are due to conditions of the adversary process itself, such as the hardening or inflexibility of adversary positions, the growth of a combative attitude, the development of the feeling that unshakeable principle is at stake, personal dislike between opposing counsel and parties, and enjoyment of the battle for its own sake. There is also the problem of sheer inability of counsel or client to appreciate the flaws in a position.[1/]

An otherwise achievable settlement should not fail for such a reason. What can be done to prevent it? Of course, counsel can be better prepared and educated about the process of negotiations in the context of litigation. There are also mediation, arbitration, and other non-judicial means to resolve disputes. Historically, particularly as crowded dockets have created the incentive, the adjudicators can help bring about settlement. Many trial judges take an active role in facilitating and even urging settlement. Their intervention can be a powerful aid and spur to settlement. But there are limits on what the judge who will decide the case can properly do. The trial judge must avoid anything resembling prejudgment and must not engage in off-the-record substantive discussions, particularly ex parte, even though most mediators find these to be a very frequent and useful technique. Moreover, the trial judge's workload creates his own independent interest in settlement, an interest that in several ways may make one or both parties discount his efforts.

These limitations can be avoided by having someone who is not the judge attempt to facilitate settlement. This is not a perfect solution, for although a non-involved mediator can deal much more openly and fully with the parties individually or together, and frequently come to the negotiation table with

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[1/] The various barriers to settlement inherent in litigation have been recognized and discussed by proponents of alternative dispute resolution techniques. See, e.g., T.D. Lambros, The Summary Jury Trial and Other Alternative Methods of Dispute Resolution at 468 (1984); Edwards, Alternative Dispute Resolution: Panacea or Anathema, 99 Harv. L. Rev. 668, 670 (1986); Susskind & Madigan, New Approaches to Resolving Disputes in the Public Sector, 9 Just. Sys. J. 171, 179-80 (1984) (recognizing that the "adversary nature of litigation tends to polarize disputants, discouraging open communication, the sharing of information and joint problem solving").

special negotiating skills, such a person nonetheless lacks the authority and experience of the judge.[2]

An ingenious device seeking to obtain some of the best from both worlds is the use of "settlement judges." A settlement judge, in this parlance, is a judge who will not try or have any formal decisionmaking authority in the case, but who is the same kind of judge, and is from the same bench,[3] as the trial judge, and who generally hears the same or similar kinds of cases. The Federal Energy Regulatory Commission, under the guidance of its Chief Administrative Law Judge, Curtis Wagner, has used settlement judges to great benefit for about ten years. The Occupational Safety and Health Review Commission has more recently promulgated regulations instituting the practice. The Administrative Conference has called in agencies to explore its use.

We urge that the settlement judge device deserves much wider consideration and application as a means of actually settling matters, or convincing the parties to undertake other means of dispute resolution. Settlement judges are not a panacea, but one means of facilitating settlements that, in appropriate circumstances, may be of great value. We first provide a brief historical look at the use of settlement in judicial and administrative proceedings (Part I). We then describe FERC's and OSHRC's regulations (Part II), and how the settlement judge device works compared to trial judges in attempting to facilitate agreement (Part III). We then seek to examine the sources of settlement judges' powers and the kinds of disputes in which those powers are most and least likely to be effective (Parts IV and V). Finally, we recommend that federal agencies who wish to encourage and facilitate settlement of adjudicatory proceedings give favorable consideration to the use of settlement judges (Part VI). We believe this can most fruitfully be done where dockets are crowded, where cases tend to present fact-bound issues of relatively little importance or policy or precedent, and where remedy is flexible enough to be the subject of negotiation. We also suggest procedures for implementation of the device, including tie-ins to mediation and other types of alternate dispute resolution, balancing gains in efficiency against possible abuses that may result from an increasing reliance on settlement in administrative proceedings.

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[2] See Cooley, Arbitration v. Mediation, 69 Judicature 263, 268-69 (1986) (discussion of impact that different levels of power wielded by third party negotiators, such as an arbitrator or mediator, has on achieving resolution of conflicts). It has been suggested that the more aligned with the court that a third party negotiator is perceived to be, the greater "power" the negotiator has and consequently, the greater the likelihood of settlement is. See Susskind, Court-Appointed Masters as Mediators, Negotiation Journal 295-300 (Oct. 1985).

[3] Given the ever-increasing workload of certain administrative law judges and possible limited availability for appointment as a settlement judge, an alternative source of settlement judges would be the currently retired ALJs who have notified the Office of Personnel Management that they would accept temporary appointment, pursuant to 5 U.S.C. § 3323(b), enacted in 1984.

I.

THE DEVELOPING USE OF SETTLEMENT AS A MEANS FOR RESOLVING DISPUTES IN JUDICIAL AND ADMINISTRATIVE PROCEEDINGS

Since court dockets first became crowded, settlement has been a popular and much utilized means for disposing of disputes.[4] In the early twentieth century, with the explosion in industrial and commercial activity, courts in the United States utilized conciliation procedures as a means for "producing harmony among the parties and resolving disputes with communitarian values."[5] In the 1920s, as court calendars became more congested and delays in reaching a judicial resolution of a conflict became longer, settlement increasingly was viewed as a tool of efficiency.[6] One means by which settlement was promoted by the courts was through the establishment of a "conciliation" docket.[7]

This process has proceeded so far that a party's actual right to refuse to consider settlement and insist on a court actually deciding his case has come into doubt. Rule 16(c) of the Federal Rules of Civil Procedure was amended in 1983 to provide that settlement and "extrajudicial procedures" for resolving disputes are desirable and may be a subject at pretrial conferences,[8] while subsection (f) of the rule provides for sanctions for failure to appear at, to be prepared for, and "to participate in good faith" at such conferences. While the advisory Committee's Notes state that "it is not the purpose of [the Rule] to impose settlement negotiations on unwilling litigants," but merely to provide "a neutral forum," few litigators would deny that the Rule now gives even greater power to courts to "suggest" that parties settle.

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[4] See Menkel-Meadow, For and Against Settlement: Uses and Abuses of the Mandatory Settlement Conference, 33 U.C.L.A. L.Rev. 485, 490 (1986) (hereinafter "For and Against Settlement").

[5] See id.

[6] Id. (citing M. Vallanta, The Emergence of The Judge As a Mediator in Court Cases (1984); see also, Cooper, Pre-Trial Procedures in the Wayne County Circuit Court in the Sixth Annual Report of the Judicial Conference of Michigan at 61, 72 (1936) (pretrial hearings were first utilized in the Wayne County Circuit Court in 1929 when trial docket was approximately 45 months behind).

[7] Id. (noting the establishment of a "conciliation" docket by the Wayne County Circuit Court in the late 1920s, followed by the establishment of similar dockets in city courts in Cleveland, Milwaukee, Boston and New Jersey).

In addition to settlement conferences, courts have engaged in broad and growing use of other means for facilitating early disposition of cases, including arbitration, special masters, mediators, and the use of summary jury trials.[9]

As with the courts in earlier decades, the administrative process has sought to provide alternate mechanisms for disposing of the great number of cases that now arise.[10] Early history of administrative settlement activity parallels court experience. Agency pretrial conferences have historically been utilized where dockets are crowded as a means for either settling entire cases or narrowing the issues. An important model in use even prior to the enactment of the APA was the pretrial conference frequently employed in the administration of the District of Columbia's workmen's compensation claims. In its report to the Senate in 1941, the Attorney General's Committee on Administrative Procedure noted that every contested case of an employee's claim for compensation was set for conference before hearing, which was attended by a claim examiner, by the issuer's representative, the claimant and the claimant's counsel. The Committee noted that about 1,000 cases were "disposed of annually by agreements produced by the conferences, and only about 100 remain[ed] for formal hearing." The Committee further noted that numerous other administrative bodies used pretrial conferences to speed the resolution of cases, such as the Board of Tax Appeals, the Social Security Board, the Civil Aeronautics Board, the Interstate Commerce Commission and the Securities and Exchange Commission.

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[8] Notes of the Advisory Committee on Fed. R. Cir. P. 16 explain that one of the considerations for amending Rule 16 was the recognition of the need for a means of relieving the condition of congested trial calendars and disposing of cases with less cost and delay.

[9] *See* Barnett, *Practical, Innovative and Progressive Utilization of United States Magistrates to Improve the Administration of Justice in the United States District Courts*; *see also* D. Marie Prwine, *Settlement Strategies for Federal District Judges* at 43-67, Federal Judicial Center (1986).

[10] *See* Aministrative Procedures in Government Agencies, Report of the Committee on Administrative Procedure, 77th Cong. 1st Sess., Sen. R. (1941); *see also* Riggs and Dorminey, *Federal Agencies' Use of Alternative Means of Dispute Resolution*, 1 Ad. Law J. 125; Harter, *Points on a Continuum, Dispute Resolution Procedures and the Administrative Process*, 1 Ad. Law J. 141.

Although the Committee generally recommended additional use of the pretrial conference by agencies to induce settlement, it noted certain inherent limitations on the extension of its use. A prerequisite to the success of such prehearing conferences, the Committee found, is that they be conducted by an "agency official of dignity and ability, and that counsel be willing to cooperate." It noted that such conferences are not as successful when agency heads fail to give adequate authority to the representatives of the agency. It is our conclusion, discussed at length herein, that this observation is correct and of great significance in devising means to induce settlement among counsel and parties. The Committee also noted that in circumstances in which an agency is being called upon to "administer its statute uniformly and according to law and the public interest" the administrative agency is not in the position to engage in the trading of concessions and that, as a result, the "scope of prehearing conferences is narrower in administrative proceedings than in private litigation." Id. at 67. The Committee concluded that "none of the difficulties are insurmountable, and that wider and more frequent use of the pretrial hearing in many agencies would be an advance over present administrative procedure." Id.

When, shortly thereafter (in 1946), the Administrative Procedure Act was enacted, the majority of hearings being conducted by administrative law judges (then called hearing examiners) involved economic regulatory matters. As the "policy" issues which typically arise in cases involving economic regulation became more and more subject to resolution by rulemaking,[11] rather than the more formal adjudicative proceedings, and the number of cases not presenting such issues continued to increase, the percentage of hearings presided over by ALJs on such regulatory policy issues decreased. Currently, the majority of cases over which ALJs preside do not involve broad regulatory issues and are more amenable to (or appropriately resolved by) settlement. One device that agencies may find useful in facilitating settlement is the "settlement judge" device, discussed below.

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[11] See Lubbers, A Unified Corps of ALJ's: A Proposal to Test the Idea at the Federal Level, 65 Judicature 266, 268 (1981); Palmer, The Evolving Role of Administrative Law Judges, 19 New Eng. L. Rev. 755, 784 (1984).

II.

REGULATIONS GOVERNING THE USE OF SETTLEMENT JUDGES BY ADMINISTRATIVE AGENCIES

A. The Federal Energy Regulatory Commission's Settlement Procedures

The Federal Energy Regulatory Commission ("FERC"), which originally promulgated regulations governing settlement procedures in 1949, amended them on July 8, 1980 to provide for the appointment of a Settlement Judge to preside over settlement negotiations.[12] Sounding a theme consistently heard when an adjudicating body discusses settlement, the Commission noted that "one of the [its] most important and continuing objectives has been to reduce delay in the decisional process" and that the appointment of a Settlement Judge was intended to promote and encourage "the use of the settlement process as a means for expeditiously resolving cases." 45 Fed. Reg. 45902. "[T]he Settlement Judge, as a knowledgeable and neutral person of authority, would be in a position to lend a structure to the negotiations and reduce the adversarial nature of the process. In addition, the Settlement Judge will be able to control the pace of the negotiations and to objectively assess and report to either the Commission or the Chief Administrative Law Judge on whether settlement is in fact likely." Id.

FERC's procedure for facilitating settlement is well established.[13] It is important to point out that settlement is routinely considered by the parties in the area of natural gas regulation before or in connection with the prehearing conference in a FERC adjudication. Many cases settle in that fashion, without involvement even of the trial judge. Only cases that fail to settle in this way are set for hearing and even become possibilities for settlement judge treatment. Rule 603 specifically governs settlement negotiations before a Settlement Judge, who is defined to be "the Administrative Law Judge appointed by the Chief Administrative Law Judge to conduct settlement negotiations."[14]

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[12] In 1978, the Department of Energy Reorganization Act, 42 U.S.C.A. § 7101 et seq., transferred jurisdiction under the Natural Gas Act, the Natural Gas Policy Act, the Federal Power Act and the Public Utility Regulatory Policies Act from the Federal Power Commission to the Federal Energy Regulatory Commission.

[13] Rule 602 governs the submission of settlement offers and applies to all written offers of settlement filed in any proceeding pending before the Commission or set for hearing under subpart E. 18 C.F.R. § 385.602(a).

On May 3, 1982, FERC reorganized and revised its rules of practice and procedure, placing them in 18 C.F.R. Part 385. Subpart F of the final rule contains the provisions on conferences, offers of settlement and settlement judges, and the refusal to make admission. Rule 603 continues the existing rule on settlement negotiations before a Settlement Judge with certain technical corrections allowing for its use in cases not set for hearing.

The rule provides that a Settlement Judge may be appointed in several ways, including a request by a participant or a presiding officer or by an order by the Commission.[15] In an attempt to address concerns about unnecessary delays caused by separate settlement proceedings, when appointing a Settlement Judge, the Chief Administrative Law Judge must issue an order specifying whether, and to what extent, the proceeding is suspended pending termination of settlement negotiations. The order may also confine the scope of any settlement negotiations to specified issues.[16]

The powers and duties of the Settlement Judge are broad and include convening and presiding over conferences and settlement negotiations and assessing the practicalities of a potential settlement. As a practical matter, references to Settlement Judges are of brief duration, and the mechanism in the regulations for dealing with lengthy proceedings before a settlement judge is rarely used. The regulations provide that a Settlement Judge report to the Chief Administrative Law Judge or the Commission, as appropriate, describing the status of the settlement negotiations and evaluating settlement prospects. In such a report, the Settlement Judge may recommend the termination or continuation of settlement negotiations.[17]

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[14] 18 C.F.R. § 385.603(b). Rule 603 applies to any proceeding set for hearing under subpart E and to any other proceeding in which the Commission has ordered the appointment of a Settlement Judge.

[15] Under Rule 603, any participant may file a motion requesting the appointment of a Settlement Judge, or a presiding officer may request the Chief Administrative Law Judge to appoint a Settlement Judge. 18 C.F.R. § 385.603(c). The Commission may also, on motion or otherwise, order the Chief Administrative Law Judge to appoint a Settlement Judge. 18 C.F.R. § 385.603(d). The Chief Administrative Law Judge may appoint a Settlement Judge if requested by the presiding officer or if the presiding officer concurs with a motion by one of the participants. 18 C.F.R. § 385.603(e).

[16] See 18 C.F.R. § 385.603(f).

To ensure that proceedings are not unnecessarily interrupted, the regulations provide that any decision concerning the appointment of a Settlement Judge or termination of settlement negotiations is not subject to review or rehearing.[18] However, if settlement negotiations are terminated, the Chief Administrative Law Judge may subsequently appoint a settlement judge in the same proceeding to conduct further negotiations.[19]

B. The Occupational Safety And Health Review Commission's Settlement Procedures

Consistent with its general policy to encourage settlement at any stage of the proceedings, on December 5, 1979, the Occupational Safety and Health Review Commission ("OSHRC" or the "Review Commission") published a final rule extensively amending its prior rules governing settlement procedures.[20] On September 8, 1986, the regulations were amended to add a provision for settlement judges.[21]

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[17] To protect against unnecessary delay, the regulations require that the first report be made not later than 30 days after appointment of the Settlement Judge (most such proceedings take far less than 30 days). The Commission or Chief Administrative Law Judge may order additional reports at any time. 18 C.F.R. § 385.603(g). Settlement negotiations will terminate upon order of the Chief ALJ issued after consultation with the Settlement Judge, unless the Commission's order appointing the Settlement Judge provides otherwise. 18 C.F.R § 385.603(h).

[18] 18 C.F.R. § 385.603(i).

[19] 18 C.F.R. § 385.603(j).

[20] *See* 44 Fed. Reg. 70106 (Dec. 5, 1979).

[21] Section 2200.101 governs the new Settlement Judge procedure. Paragraph (a), entitled "Appointment of Settlement Judge," states that the procedure applies only to notices of contest by employers and to applications for fees under the Equal Access to Justice Act, 5 U.S.C. § 504, and 29 C.F.R. Part 2204.

A settlement judge may be appointed upon request by a party or upon assignment by the Chief ALJ or Chairman with the consent of the parties.[22/]

To ensure that Settlement negotiations do not unnecessarily delay proceedings on the merits of the case, section 2200.101(a)(3) expressly limits the period for settlement negotiations to 45 days.[23/]

Under the regulations, the Settlement Judge is provided broad authority to (1) confer with the parties on subject of whole or partial settlement, (2) suspend discovery during the time of assignment, (3) suggest privately to a party's representative what concessions his or her client should consider, and assess privately with each representative the reasonableness of the party's case or settlement position, and (4) seek resolution of as many issues in the case as is feasible.[24/]

22/ Any party may move for the appointment of a Settlement Judge following the filing of the pleadings. In addition, the Chief Administrative Law Judge or the Chairman may assign a case to the Settlement Judge, with the consent of the parties at any time in the proceedings, whenever it is determined that there is a reasonable prospect of substantial settlement with the assistance of mediation by a Settlement Judge. The Settlement Judge procedure may not be imposed if either the Secretary or the employer objects to its use. 29 C.F.R. § 2200.101(a)(2).

23/ Paragraph (d) of the regulations, however, provides that, with the consent of the parties, the Settlement Judge may request from the Chief Administrative Law Judge an additional 120 days for settlement negotiations. If additional time is not required, upon expiration of a settlement period or at an earlier date the Settlement Judge shall notify the Chief Administrative Law Judge in writing of the status of the case. If a full settlement has not been approved, such report shall include written stipulations embodying the terms of such partial settlement as has been achieved. At the termination of the settlement period without full settlement, the Chief Administrative Law Judge shall promptly assign the case to a different Administrative Law Judge, unless the parties request otherwise. *See* 29 C.F.R. § 2200.101(d).

24/ 29 C.F.R. § 2200.101(b). The regulations also set forth specific guidelines for how settlement conferences shall be conducted and who shall participate. First, it is generally expected that the Settlement Judge shall communicate with the parties by a conference call. However, a personal conference may be scheduled with the parties if: 1) the Settlement Judge can schedule three or more cases for conference at or near the same location in one day; or 2) the office of the attorneys or other representatives as well as that of the Settlement Judge are

To increase the likelihood of settlement, the regulations further provide that the Settlement Judge may recommend that the representative who is expected to try the case be present at a settlement conference and that the parties, or their agents having full settlement authority, be present. All parties and their representatives are required to be completely candid with the Settlement Judge so that he may properly guide settlement discussions. Failure to be present or the refusal to cooperate fully may result in termination of the settlement proceedings.[25]

To encourage the candor sometimes necessary to achieve a settlement, the regulations additionally provide that no evidence of statements or conduct in the settlement proceedings shall be admissible in any subsequent hearing, except by stipulation of the parties. Moreover, documents disclosed in a settlement process may not be used in litigation unless obtained by appropriate discovery or subpoena.[26]

Paragraph (d)(3) prohibits the Settlement Judge from discussing the merits of the case with any Administrative Law Judge or any other person and precludes the Settlement Judge from being called as a witness in any hearing of the case. This provision was inserted in response to concerns about the small number of Administrative Law Judges employed by the agency and the possibility of improper communications between two judges in the same office. Upon consideration of these concerns, the Review Commission deleted a provision in the proposed rule that encouraged assignment of a case for a hearing to another judge from the same office as the Settlement Judge.

Similar to FERC's regulations, OSHRC's regulations also provide that any decision concerning the assignment of a Settlement Judge or the decision by a party or Settlement Judge to terminate proceedings is not subject to review or rehearing. See 29 C.F.R. § 2200.101(e).

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located in the same metropolitan area; or 3) a conference can be scheduled in a place and on a day that the Judge is scheduled to preside in other proceedings; or 4) any other suitable circumstances in which, with the concurrence of the Chief Administrative Law Judge, the Settlement Judge determines that a personal meeting is necessary for a resolution of substantial issues in a case and the holding of a conference represents a prudent use of resources.

[25] See 29 C.F.R. § 2200.101(c)(2). Paragraph (c)(2) further provides the Settlement Judge with flexibility to impose any additional requirements that seem proper to expedite an amicable resolution of the case.

[26] 29 C.F.R. § 2200.101(c)(2).

III.

SETTLEMENT JUDGES COMPARED TO TRIAL JUDGES

A main thesis of this paper is that in broad classes of cases, a settlement judge can exercise much of, and in many situations more than, the settlement-inducing authority of the trial judge, without the drawbacks inherent in the trial judge's involving himself in attempts to induce settlement. It is therefore important for us to attempt to delineate the comparative powers of both types of officer in inducing settlement. While that is the main focus of this section, it is important to bear in mind that non-adjudicators have a different set of powers and limitations, and that any discussion of trial judge versus settlement judge should not ignore these.

The differences between a settlement judge and the trial judge attempting to facilitate settlement are very substantial and generally favorable to the settlement judge device. Those differences, however, are not all that obvious.

The clearest differences have to do with the major limitations or disadvantages of involving trial judges in settlement attempts. We note that many trial judges are exceptionally able, effective, and considerate at promoting settlement, and they do so without overstepping propriety. What follows is not an attack on this practice, but an attempt to speak frankly about some of its inherent limitations.

A suggestion of settlement by a trial judge is always a suggestion, no matter how slight, that the judge believes that there is some reason for a party to settle. Such a suggestion is intrepreted by the party as meaning that if the case is not settled, the party will not obtain what he wants. Frequently--most typically when discovery or a trial is in the future--this suggestion can be made by a trial judge without impropriety because the judge is as yet unaware of all of the evidence or has not yet had received major briefing on important legal issues. When there is a jury, the trial judge may truthfully say that he is not sure of how the jury will decide. However, in cases with dispositive motions, heavy involvement of the judge in discovery, relatively simple facts, or other features that create the implication that the trial judge is already in a position to have views about all or a major portion of the case, the role that the trial judge can properly play in encouraging settlement without expressing some prejudgment is constricted.

Similarly, the trial judge's flexibility in using techniques of persuasion, reasoning, and unvarnished discussion at any time in the case are limited by the court's obligation not to have off-the-record substantive discussion with the parties, and particularly not with fewer than all of the parties in an ex parte discussion.

These limitations on maneuvering ability almost, but not entirely, disappear with settlement judges.[27] In a properly created framework, the settlement judge cannot have any part in the disposition of the case in the event that it is not settled and should not have any discussion about the case with the trial judge in the event that settlement does not occur. This frees the settlement judge to engage in just the sorts of techniques to aid settlement that the trial judge is restricted from using.

As suggested earlier, however, this freedom is not unlimited. The settlement judge, by definition, is still a judge with a caseload similar to that of the trial judge. Accordingly, the settlement judge ought not to make statements in seeking to obtain a settlement in case A that might be regarded as prejudgment or other comment on issues in another case, case B, in which the settlement judge happens to be the trial judge. The risk of such error is multiplied where, as with the FERC and many other agencies, there is a well-defined set of regulated entities that are frequently parties in numerous proceedings before the agency and where there is a similarly well-defined bar that specializes in practice before that agency. Thus the settlement judge device, unlike use of mediators or other non-judicial personnel, has the inherent limitation of usefulness to cases that, for some reason, are very unlikely to have major precedential value.

The most likely identifying factor of cases amenable to the settlement judge process is fact-specificity. By the same token, the case that is least apt for settlement judge treatment is one turning upon a broad legal or policy question. Administrative agencies, to a greater extent than courts, have particular potential for entertaining cases of great precedential or policy importance. While it is today a commonplace that courts exercise some lawmaking function, agencies typically have Congressional mandates broadly to create and enforce regulatory programs. Many major issues consequently arise in agency adjudications.

It should be observed here that the limitations discussed above would not apply to a wholly independent mediator, or a settlement "judge" whose only job was facilitating settlements and who had no responsibility to try other cases. In this very important sense, the settlement judge technique is not a true alternative to mediation, arbitration, or other non-judicial means of dispute resolution.

Instead, as more fully discussed below, it is a means of drawing unique settlement-inducing ability from the settlement judge's status as an actual sitting judge with responsibility for the same kind of cases as the trial judge. Therefore, the very factor that can make settlement judges attractive as facilitators of settlements--their judicial status--also limits the situations in which they can be useful.

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[27] *See* W. Brazil, *The Judicially Hosted Settlement Conference: Pros & Cons*, Inside Litigation, Vol. 2, No.3 (Jan. 1988) (recognition of litigation belief that a judge who hosts a settlement conference may lose his impartiality); *For and Against Settlement*, *supra*, at 511 (suggestion that settlement conference be hosted by someone other than the trial judge to avoid prejudicing later trial).

Another series of differences between settlement judges and trial judges who seek to facilitate settlement springs from the more practical aspects of the detachment of the settlement judge from the trial process. Most obviously, the fact that the settlement judge is free of any responsibility to try a case means that his settlement proceedings should be on an independent track from that of preparation for trial, so that settlement negotiations cannot be used as part of the tactics of delay, discovery or other burdens. The Chief Judge can assign as settlement judges those judges who show a particular interest and aptitude for encouraging settlement, as not all judges do (although we believe that training in settlement-inducing techniques can and should be made available to all adjudicators). In addition, a settlement judge does not have to perform the burdensome tasks associated with preparing the case for trial and trying it, and thus has no incentive from his own schedule to induce settlement.

It might well be argued that it is entirely appropriate that the pressures of preparation and trial on the trial judge, as well as the parties, should be among those factors that induce parties to settle. But these pressures are well known to the parties and their counsel, entirely apart from any settlement proceedings. They are thus pressured automatically. In fact one of the limitations on the ability of a trial judge to press for settlement is that a party may believe that the pressure of the trial judge's own docket may override what should be his concern about the substance of the settlement. This would cause a party either to discount the judge's advice or to settle anyway, with the decidely unpleasant feeling that the settlement is compelled by the tribunal rather than voluntary.

A settlement judge carries much less of this baggage, and, accordingly, has less to obstruct his acceptance by the parties as a voice of reason and fairness. At the same time his presence does not detract from the parties' awareness of the costs and pressures of litigating rather than settling. Indeed, the settlement judge is in a good position to discuss these matters with counsel without himself being personally interested. Thus these considerations are at least equally likely to be received and weighed objectively.

IV.

The Power of the Settlement Judge

The chief advantage of the settlement judge is that he is both a visitor from outside the case, who will not judge the merits--or the counsel--or have any other impact on the formal decisionmaking, and, at the same time, is as knowledgeable and authoritative on the merits (and on the trial judge) as anyone can be who is not part of that process.

Lawyers in negotiations frequently feel that someone associated with the process will not listen to reason--their opposing counsel, the opposing client, their own client. While lawyers perhaps only rarely accuse themselves of being unreasonable, we often wish we could understand how a factual or legal point we are contemplating will play in an adjudication; what we are wondering at such times is whether we will be seen to be unreasonable in asserting it. Negotiations can stick on such points.

The course of ordinary litigation is not helpful here. The posture required by the adversary process is a great enemy of bridging this gap. Then there is the chance that the adversary posture, held for long enough, will stiffen into belief. It can be extremely difficult for an advocate to unbend into the flexibility of ordinary discourse for settlement purposes. This is all the truer where the trial judge is attempting to facilitate settlement. Given that counsel feel, we may assume correctly, that in formal appearances before the trial judge they cannot unbend at all, it is very difficult for them to do so in informal appearances, perhaps because such an unbending would constitute an uncomfortable admission that the formal views were largely posturing.

In this connection the settlement judge device fights fire with fire. The deadlock on the trading of reasonable views is broken by use of another habit of litigation: the respect and deference that are due to a judge. In normal litigation, the judge's suggestions are followed, his suppositions are treated as reasonable, his jokes are laughed at--in public and on the record. Counsel may believe the suggestions unwise or jokes unfunny, but they keep those reactions to themselves. In a sense, the trial judge is the perfect person to suggest that the parties talk settlement in a reasonable manner, because counsel are in the habit of taking his suggestions. But, as pointed out above, the trial judge is constricted in approach because of the risk of the appearance of prejudgment or other improprieties. Nor is this paradoxical, because without impartiality, trial judges in general would not get, or deserve, respect and deference.

The settlement judge, by being a judge but not the judge who decides the case, can command a similar degree of deference without the need to observe the due process commands that establish and maintain impartiality. The settlement judge can use his position (including such devices as off-the-record discussions, ex parte communications, prediction of outcome, and so forth) to suggest to the parties that they talk sense instead of posturing. Just as repetition of adversary views tends to lead counsel to think those views are correct, so repetition of reasonable views may break that habit. Most litigating lawyers are aware of a phenomenon that occurs when it becomes clear that a case will be settled. There is an attitudinal change, sometimes partially or wholly marked, when difficulties and disagreements become things to be understood and ironed out; from then an effort is expended on resolving differences rather than developing them into adversary positions. The role of the settlement judge is to get the parties to drop the adversary pose and to expend efforts to reach that stage of accommodation.

Of course the settlement judge has no power in the case and thus does not wield the ultimate threat--of loss--that makes counsel so amenable to whatever the trial judge wants. Settlement is a voluntary, and not an imposed, process. The settlement judge cannot force the parties to settle and should not try. What is needed is something to get the parties over the stumbling block of excessive regard for their own positions. The habit of deference to a judge, we believe, can do this. It does not hurt the process, moreover, that the settlement judge is a trial judge in other cases, before whom counsel and parties must assume they will appear in the fullness of time. There is no need to appear to be unreasonable to such a personage while he is serving as a settlement judge.

The second major advantage of the settlement judge is that he speaks with authority, of two kinds. We note preliminarily that the classic rationale for settlement is the trading of the uncertainty of litigation, in which one might win or lose everything or reach some middle or completely unanticipated or even inapt result, for the certainty of a negotiated one, in which one knowingly receives a compromise. One might assume from this commonplace, and it is often said, that the greater the uncertainties, the greater the incentive to compromise. We believe that to be incorrect. The magnitude of what is at stake may induce compromise in those situations where one of the litigated outcomes may be disaster. But in most cases, disaster is not a possible outcome. In such situations, the less uncertainty there is in the parties' and counsel's minds about how particular factual or legal issues may be decided, the more apt the case is for settlement (as long as both sides believe that the case is not a certain winner for them). Clients, rather logically, always wish to know exactly what is the chance of success on each issue. If they had that information they could make the decisions necessary to arrive at a settlement. Their lawyers cannot supply it, because they do not know or do not agree (or do not know whether they agree) with the opponent's assessment.

Here is exercised one of the great advantages of the settlement judge. He is generally knowledgeable about the kind of case; he knows how such cases are handled, how much time and effort they take, and, frankly, what kind of a reception the trial judge will give the legal and factual issues they present. He knows the trial judge professionally and personally and he is a judge himself, whose daily work it is to resolve such disputes. He is just the person, therefore, to provide an authoritative estimate of such matters as how a particular approach would be received, how weighty particular facts are in decision of a particular issue, and how legal questions will be decided.

We emphasize that it is not necessary for the settlement judge to predict how the entire case will be decided; all he need do, to greatly increase the chance of settlement, is reduce the scope of the parties' and counsel's disagreement over the chance of the outcome on one or more issues.[28]

This authority with which the settlement judge speaks is not limited to his de facto knowledge based on experience. His position as a judge should add greatly to his effectiveness. Of course, the fact that he is a judge shows how he got his information and that its provenance is satisfactory. But he also speaks as a judge, not simply a lawyer or a lay person.[29]

A settlement is not simply a business deal allocating business risks. If that were all that was involved, the parties ought to have settled the matter without resort to litigation. We pointed out above that at the FERC, most settled cases are settled by the parties themselves, before or in connection with the preliminary conference. But many cases fail of settlement in this way, and we believe it a serious error to assume that parties can be asked to settle cases that get as far as actual litigation by treating the issues as business questions to be settled as other such questions are settled. The parties are in litigation because one or both of them have seen something more in the problem, and likely the decision to litigate was not made casually. The parties, in short, think that they have done enough to merit the attention of the adjudicatory system. Our system fosters the view that it is available for the resolution of disputes, and clients feel that they are entitled to an official resolution of their disputes--what is popularly called a day in court. If that official decisionmaking system meets them halfway with an official, authoritative, but still non-binding and non-prejudging review of the questions of whether settlement is appropriate, they may feel that their perceived need to invoke adjudication has been responded to.[30] In addition to facilitating settlements, the settlement judge device also can help maintain the feeling that the adjudicatory process is not so costly or otherwise demanding of time and effort, or so disregading of persons, as to be effectively unavailable.

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[28] For example, the parties may disagree over such matters as whether it was relevant that one of them acted in good faith; whether particular facts showed good faith; whether a particular course of conduct was reasonably designed to bring about a desired end or be consistent with some statutory goal, etc. Such issues are frequently central, and yet parties and counsel may feel themselves unable to assess how their positions will be received or disagree with their opposition over their importance.

[29] Because he speaks as a judge with a judge's power and authority, parties also are less likely to be skeptical about the value of the informal settlement process and more likely to view it as a legitimate and potentially useful means for reaching an enforceable settlement. See Court-Appointed Masters, supra, at 485 (recognizing that parties' perceived value of mediation corresponds to parties' perceptions of authority wielded by mediator).

V.

WHERE THE SETTLEMENT JUDGE DEVICE WORKS WELL

As we have emphasized, the settlement judge is most apt to be successful in particular kinds of cases--far from all of them--in which there is some obstruction to settlement upon which the settlement judge can exert his considerable powers. We discussed in general above that a settlement judge is well equipped to deal with and to derail adversary attitudes of client or counsel that have made it difficult to talk settlement. In detail, there are many attitudes and combinations of possibilities that the settlement judge is in a fine position to deal with. Most typically, as described above, the two sides have worked themselves into hardened adversary positions in which one or both feel that to raise the possibility of settlement is too much of a concession. This may be correct or incorrect. In either case, the settlement judge process can be invoked without making this concession.

This is illustrated by the story of how the settlement judge device was first used at the FERC (then the Federal Power Commission). Judge Wagner had presided over, and decided, Atlanta Gas Light Company v. Southern Natural Gas Company, Docket No. CP74-329, a case in which the position of the Public Service Commission of Georgia had been presented by the state's governor, Jimmy Carter, who was successful. On October 18, 1976, weeks before the election of Mr. Carter as President, the Commission modified and affirmed Judge Wagner's decision. 56 F.P.C. 2346 (1976). However, rehearing was sought and granted on December 17, 1976 (id. at 2346 n.*) with the Commission ordering new briefing. In the meantime, the election of President Carter, whose position had prevailed up until then, made matters somewhat awkward for the Commission. The possibility of settlement, a perfect solution to this situation, had been negated by several parties who "wanted to fight." The new governor of Georgia suggested that Judge Wagner, who was of course fully knowledgeable about the case but had no further responsibility in it, try to assist the parties to settle. Judge Wagner took up the suggestion, and using his unique knowledge and persuasive abilities, was able to effectuate a settlement despite the insistence by several parties at the outset that they would never settle. Impressed by this success, the Commission promulgated its regulations establishing the settlement judge device and making it broadly available where settlement had not been achieved by other methods.

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[30] Other alternative dispute mechanisms, such as summary jury trials, also have been recognized as useful ways of breaking down barriers to settlement such as the litigant's emotional need for a "day in court." See The Summary Jury Trial, supra at 468.

There are, moreover, many other kinds of situations in which parties or their counsel are unwilling or unable to proceed on settlement by themselves, in which a settlement judge may break the deadlock. For example, there is frequently an explicit or implicit disagreement between a lawyer and his client as to the strength of a position. Generally, lawyers think that this arises most where the client simply will not understand that his case is not perfect, and his counsel either cannot make him see that there is a good chance of losing or is reluctant to be emphatic enough. In our experience it happens the other way, too, when counsel who, having been bitten by the adversary bug, think that a particular legal issue is very strong or important, while the client, perhaps not caring for the beauty of the issue but more likely having a more down-to-earth approach, fears otherwise.

A closely related frequent occurrence is a feeling by parties or counsel that they are unaware of how their position will be received by the trial judge. This uncertainty occurs not only with novel issues, but with fact-specific situations where prior decisions do not provide clear guidance.

In these kinds of cases, the parties may want to settle but be unable to. It is very difficult for a lawyer to advise settlement or for a client to accept it wholeheartedly where they disagree over the strength of their position or where they are completely at sea over the strength of their position. A settlement judge can provide guidance as to how the trial judge would receive such questions. If the uncertainty of a party's or counsel's view of their own case can thus be diminished, settlement should be facilitated. This is, of course, also true where the deterrent to settlement is one side's (or both sides') unreasonable resistance to the proposition that it or they might be wrong. Most parties would like to settle, even those who, stubbornly adhering to an unreasonable position, are of course unlikely to be aware that they are being unreasonable. Therefore, there should be little resistance to the suggestion that a settlement judge be consulted on such issues.

This discussion suggests that agencies may find it profitable to institute use of settlement judges in areas in which settlements are not frequently reached by the parties or other means have not been successful. As we have stressed, a major benefit of settlement judges is their ability to break the ice in an awkward situation in which any of numerous kinds of problems may be inhibiting discussion of settlement. This is confirmed by the FERC's recent experience with cases arising not within its traditional natural gas jurisdiction (in which, we noted above, there is a well-established practice of settlement negotiation before the adjudicatory stage), but from cases from the Department of Energy's petroleum allocation and pricing regulations, in effect from 1973 to 1981. In these cases, there is not the longstanding tradition of significant efforts by the parties at settlement before adjudication begins. The FERC has been able, using settlement judges, to induce negotiation and settlement of significant numbers of its DOE cases, breaking the ice, introducing the practice of negotiations and settlement on a case-by-case basis where it did not exist before.

A generalization may be deduced from this with some assurance: that starting to use settlement judges may be a fine way for an agency to introduce the idea of settlement in proceedings in which settlement is not now frequently pursued. Where the presence of other factors seems to make particular kinds of proceedings apt for settlement but settlements in fact are not routinely sought or achieved, we would hazard the guess that lack of that achievement is attributable to absence of habits or procedures to break the adversary mold and facilitate settlement. In such circumstances, an agency could make the settlement judge procedure available, perhaps preceded by seminars or other devices to permit its administrative law judges to learn settlement-inducing techniques from others experienced in them. We further assume that in individual cases or classes of cases that one outcome of use of a settlement judge might be the acceptance of the parties that they turn to mediation or other non-adjudicatory means to work out the details of a settlement. The considerations inducing parties to settle being as weighty as they are, this should lead to an increase in settlements.

We have stated above that the settlement judge device works best when only unique issues, generally not of precedential significance, are involved. Reasons for this are several. Most clearly, unlike the normal settlement process involving only the parties reaching agreement, the settlement judge process does involve an adjudicator making statements on the issues, but off the record and, at least in some cases, ex parte. Unless those statements are utterly irrelevant to any other case, they can begin to constitute secret law, known only to one or more parties, useful to them in future disputes. Undoubtedly a certain degree of this is tolerable, since judges every day make remarks having implications beyond the cases in which they were uttered, which, while formally on the record, are as a practical matter available only to those parties to whom the statements were made. But a main difference is that the decisive judicial statements in an ordinary case are most likely to be recorded and preserved; the most important statements made by a settlement judge will almost always be a secret, like everything else he says.

Secret law, or law imperfectly known and developed, is undesirable for many reasons, but is especially injurious to the policy of getting controversies settled without adjudication. The clearer and better known the law is, the fewer disputes over it that will arise and the more readily they will be disposed of. For this reason alone, using the settlement judge procedure on issues of major precedential importance would be penny wise and pound foolish: formal and authoritative disposition of such issues will squelch their arising in the future, but parties will continue to dispute unknown or imperfectly resolved issues.

The administrative law judges at FERC and OSHRC who were interviewed for this paper were unanimous in their belief that issues of significant precedential and policy import should be decided by the usual means for just these reasons (as well, of course, as their general feeling that their job is to make the law known and to create precedent rather than to keep it secret and unknown).

Therefore, from at least the point of view of dispute resolution, the settlement judge device is not a satisfactory way for a court or agency to avoid publicly resolving a point of precedential importance that affects others in addition to the individual litigant involved. Even if such a case could be settled (and as we have pointed out, great uncertainty as to the law does not promote settlement in particular cases), the issue would merely arise again just because its importantce extends beyond the particular dispute settled.

We believe also that a settlement judge is less able to promote settlement of a case with major legal or policy issues. The effectiveness of the settlement judge depends in large part on his ability to speak authoritatively about the likely disposition of issues in the case. The more novel and policy-oriented the issues are, the less able anyone other than the agency itself will be able to pronounce credibly upon them, and the more that settlement may come, if at all, through the parties' own compromise or with a non-judicial technique such as mediation.

A settlement judge should also be able to do his work quickly, as it would be wasteful and inefficient to spend a great deal of time learning the circumstances of a case only to have it fail to settle. For this reason, cases of unfamiliar, complex, or arcane facts, or requiring unusual expertise, which would call for a substantial investment of time for the settlement judge to become familiar with, would not seem to be good candidates for this device. However, it may be that particular agency experience would show that the success rate with such cases is high enough to warrant the investment of time. Such judgments should be made by the Chief ALJ or presiding officer, whose knowledge and ability to deal with such questions should advance rapidly with experience.

All of these factors strongly suggest that the settlement judge device works best with cases presenting factual issues of minimal precedential value, where the basic applicable legal principles are clear. Given the changes in the types of hearings conducted by administrative law judges over the last forty years, use of the settlement judge device should prove to be a very useful tool.[31]

31/ See A Unified Corps, supra, at 268-69. As noted earlier, rulemaking hearings conducted by agencies in formulating policy occupy "a shrinking percentage of the federal administrative judiciary." Today an ALJ's function is much more judicial,

VI.

Limitations on Settlement Judge Use

The important, truly distinctive feature of the settlement judge device is the judicial status of the settlement judge. That status is the source of his power. But it must not be compromised. We are recommending a truly consensual process, in which with the agreement of the parties a settlement judge seeks to facilitate a voluntary settlement with which the parties are satisfied. We are not recommending a new judicial function intended to dampen ardor for litigation by dispensing justice in an informal, off-the-record way. The very potency of the judicial office means that its use must be limited to avoid abuse or compromise--limiations that do not burden other dispute resolution methods that are by their nature consensual, most notably mediation.

Several innocuous-sounding avenues would, we think, lead to misfortune for this reason. Most importantly, as we have already stressed, the settlement judge device should not be used in cases involving issues of significant importance beyond the case.

A less obvious point involves cases in which the remedy available is not susceptible of gradation. Sums of money, rates that may be chargeable, degrees of activity that are licensed or prohibited all can be negotiated and compromised. But where the question may be answered only yes or no, then settlement must merely be one side or the other giving in. While it is possible that a person in the position of a settlement judge could help convince one side or the other that it is to its benefit to surrender completely, this seems a relatively unlikely prospect. Moreover, if one side must take nothing if it does not prevail, then the system inspires the most confidence and respect if it assures a full adjudication, and the role of the settlement judge would not seem beneficial. Parties who were unhappy with the result or felt forced into it would in retrospect regard the settlement judge process as a bootleg, shortcut vehicle under which they had signed away their due process rights. Therefore, we believe, the device should not be used in situations where the legal remedy choices are so limited that one or the other party must give up entirely.

The settlement judge device should not be used, also, in any case in which it is not requested by a party or by the trial judge. In those situations in which the parties are already negotiating, they should be left to do as much of the work themselves as they can--all of it if possible. The settlement judge, again, is an aid to the parties' attempt to reach a true voluntary agreement. His presence where that aid had not been requested would be superfluous for that purpose and therefore subject to misconstruction. In this connection, we believe that

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involving emphasis on hearing evidence and making findings of fact.

the trial judge should also be able to recommend that the parties consult a settlement judge, because the trial judge is in a perfect position to see the existence of conditions suggesting that a settlement judge may be useful. However, the trial judge's recommendation should not state any reasons.

Finally, in the event that the settlement fails, the settlement judge's report back should constitute only the unexplained and undetailed statement of that fact, without attributing any view to any party and without any assessment. Similarly the parties should be forbidden from making any reference to anything said by themselves or the settlement judge. The process will not be inviting if it is not fully confidential, and the settlement judge should in any event not be quoted as making any statement about the merits, the trial judge, the reasonableness of counsel, and so forth. Nor should the parties have to be concerned that the settlement judge will say anything on such subjects to the trial judge.

VII.

Recommendation

In 86-3, the Administrative Conference of the United States called for greater use of settlement judges. The following are some recommendations that provide detail for that general notion. We recommend that agencies consider institution of the settlement judge device in the following situations, and with appropriate limitations:

A. Factors suggesting the use of settlement judges would be appropriate and fruitful.

We believe that unless any of these factors are present, the device will not be worth the effort, but that where one, and particularly more than one, are present, there is good ground to expect their efficient and successful use.

1. Crowded dockets with relatively few cases being settled. Where a large proportion of cases is being settled without the use of settlement judges, it may very well be that the availability of settlement judges would further increase the number of cases settled, but the effort of introducing a program would be proportionally greater.
2. Presence of a large proportion of factual issues which are not of major precedential importance. This is all the truer where the facts in those cases are relatively undisputed, and the primary issues concern the interpretation or characterization of them. Broad questions of fact or law are ill-suited to the settlement judge process.

3. *Remedies susceptible to gradation and, thus, to compromise*. Examples are sums of money, dollar rates, degrees of restrictions or activity, etc. The less flexible the remedy, the less apt is the settlement judge device to be successful.

B. *Procedures*.

We recommend that agency procedures providing for and implementing the use of settlement judges contain the following.

1. *Who may suggest a settlement judge*. The suggestion that a settlement judge be consulted may be made at any time to the agency's Chief Administrative Law Judge by any party or by the trial judge. At the FERC, the suggestions usually come from the trial judge, the parties having generally discussed settlement themselves before the adjudication began. An experienced trial judge can, and should, be quite insistent that the parties make an attempt before a settlement judge. Any party may veto such a suggestion.
   a. The invocation of the device must be made easy to avoid the chance that routine posturing will defeat its use. This may lead to references to settlement judges of parties who do not think they are prepared to settle. But as long as settlement is possible, this attitude is grist for the settlement judge's mill.
   b. It will generally be foolish for any party to veto the suggestion that a settlement judge be consulted, but the veto power is advisable to avoid utter waste of time.
   c. Similarly it will be clear that there are many times when a settlement judge should not be requested.
   d. The Chief Administrative Law Judge will develop great experience about such matters as which judges make good settlement judges for which situations, issues, personalities, and so forth. He will also be able to refuse to appoint a settlement judge in those situations--few, we believe--in which it is appropriate not to do so even though a request has been made.
2. *"The Agency" should generally avoid recommendation*. The "agency" in the sense of the agency's ultimate decisionmaking body

(see 5 U.S.C. § 551(1)) should ordinarily not retain authority to suggest a settlement judge. The agency is much less likely to know when a particular case is apt for settlement and much more likely to desire a case to be settled to avoid having to decide it. It is unwise to involve a settlement judge to achieve such ends, as it compromises his judicial status.

3. Nature and length of proceedings before settlement judge. Experience at the FERC has shown that proceedings before a settlement judge should not be lengthy or elaborate.

   a. Start soon. The settlement judge should, within days after appointment, meet with the parties together and (usually) separately to determine what obstructs settlement.

   b. Timing. The timing of a request or suggestion for a settlement judge should be flexible. A party or the trial judge may realize at any of a number of points during the prehearing proceedings (after the initial pleadings, after some or all discovery, in connection with a motion, etc.) that settlement may be feasible. There is no way to predict when this may occur or force those involved to make it occur at any particular point.

   c. Techniques. There is no way to provide a road map of techniques to be applied, but in general the settlement judge should discourage unreasonable positions, suggest likely outcomes, suggest that the parties think about how to reach agreement rather than how to take adversary stances, and facilitate communications between the counsel and parties. The settlement judge should encourage and facilitate reaching these goals by reminding the counsel and parties that the proceedings are not on the record and cannot be cited or used in litigation.

   d. Short duration. Generally, proceedings before a settlement judge should be short--a few sessions, concentrated in a few days. Particular agency experience may warrant lengthier proceedings, where the Chief Administrative Law Judge concludes that the chance of success warrants. The problem is generally one of breaking the ice; once the obstructive attitudes change or the necessary information is supplied, the parties can continue to negotiate by themselves. If assistance in lengthy negotiations is necessary, a mediator or similar person may be useful. If deadlock again develops, a fresh reference to the settlement judge may later be made.

e. No elaborate proceedings. What the settlement judge can supply he can supply quickly. It is not efficient for him to spend lengthy periods considering what would be evidence in a formal hearing when settlement judge removes any incentive to a party to use such proceedings for delay or other tactical advantage. If the parties genuinely need and wish some methods of presenting evidence in a settlement context, the settlement judge may refer them to a separate mini-trial process.

f. Parties have authority to settle. The parties who attend proceedings before a settlement judge should be required to have realistic authority to settle. In large cases this may be impossible, but in such cases the settlement judge should require the persons appearing to be in a position to recommend settlement and to obtain a quick decision from their principals.

4. Proceedings before the settlement judge off the record; sanctions. The agency must provide by regulation that all proceedings be off the record and not subject to citation or reference in any other proceeding. This includes the statements of the parties, their counsel, and the settlement judge. Participants must be assured going in that they may speak freely, as otherwise they will be tempted to adhere to their litigating positions. As to the statements of the settlement judge, this should not be waivable. Nor should such statements by the settlement judge or the parties be admissible or subject to consideration by the trial judge or on appeal or judicial review. There will be severe temptation of parties to quote statements of opponents or the settlement judge. The agency should provide sanctions to dampen this desire.

5. Advice to trial judge of results of settlement judge proceedings. At the conclusion of the settlement procedures,

either the parties should tell the trial judge that they have settled, or the settlement judge should advise the trial judge, of the simple fact, with no elaboration of any kind, that settlement has not been reached. To assure confidentiality of the proceedings, the agency's regulations should dictate the formula by which the trial judge is advised that settlement has not been reached.

6. *No stay, except by trial judge*. Existence of proceedings before a settlement judge should not stay proceedings before the trial judge. Otherwise there would be too much temptation to feign interest in settlement. Moreover, as stated above, proceedings before a settlement judge should not be so lengthy as to make a stay of much pertinence, unless the case is close to trial or at some other such critical stage. Then the parties should ask the trial judge for a stay if they need it, with the settlement judge saying nothing about whether the stay should be granted, it being the trial judge's docket that would be affected by a stay. If the case is stayed, the settlement judge should be told.
7. *Settlement like any other*. A settlement arrived at with the help of a settlement judge should be treated like any other, with respect to such matters as approval by the trial judge or the agency, opportunity for public comment, and the like. Of course such further proceedings should not breach the confidentiality of the settlement process.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-6

JURISDICTIONAL DEBATE IN ADMINISTRATIVE LAW: A COMMENT ON TELECOMMUNICATIONS RESEARCH AND ACTION CENTER V. FCC

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Introduction

Debates about judicial review remain at the center of modern administrative law. They often turn on alternative choices framed by the principles of administrative process. For instance, a major controversy concerns the extent to which judicial review, as opposed to executive or legislative oversight, should be a central means of controlling and legitimating agency behavior.[1] Another common debate asks whether one should emphasize a general presumption of reviewability or make a special effort to carve out areas from judiciary review.[2] Others argue whether judicial review should be dominantly procedural or substantive. Since the Supreme Court cut back on free-wheeling procedural review,[3] controversies have raged about whether substantive review should focus on questions of legal authority, or whether it should concentrate on the rationality of agency decisionmaking under an evolving "hard look" approach.[4]

These and related topics, while important, tend to take for granted one of the most basic questions in administrative practice: assuming there is to be judicial review, in which level of court in the federal system -- district or appellate -- should it occur? To be sure, the question of forum allocation is noted in major sources on administrative law.[5] But it is often not focused upon in the literature as a major zone of contention in its own right.[6]

To some extent, discussions of forum allocation may seem relatively less vivid in the literature precisely because they are such practical controversies. Just go one place or the other, the hard-headed critic might say, and carry on, for heaven's sake. Moreover, the choice of forum generally turns on interpreting an agency's statutes, which may or may not contain a special review provision channelling actions directly to the courts of appeals. What can be more straight forward than following the rules laid down by Congress?

In fact, however, beneath the surface boils a cauldron of competing values, interests, and visions. These different ideas play a major role in structuring judicial analysis of what are often vague or at least not clearly applicable forum allocation provisions. Understanding more fully that concatenation of ideas is this report's central aim.

The focus of this study is a leading but not much-discussed forum allocation decision, *Telecommunications Research and Action Center v. Federal Communications Commission* (*TRAC*).[7] In that case, the plaintiffs challenged allegedly unreasonable agency delay.

The court raised the question of its jurisdiction over such a preliminary challenge. After a relatively brief but significant analysis, the court concluded that it had exclusive power to hear the claim. Specifically, the court held that when an agency's statute assigns final action to a court of appeals and when a preliminary challenge to activity under that statute is brought, the court of appeals has exclusive jurisdiction to hear the preliminary claim so long as relief in relation to it might affect the court's future jurisdiction.[8]

TRAC was an attempt to clarify forum allocation principles. I will argue that it did not achieve this laudable goal. I also will contend that its method of analysis is unduly abstract and formalistic. In addition, I will suggest that its substantive result -- preference for exclusive appellate power --runs contrary to major policy considerations in this area of the law. In short, I will urge a rethinking of *TRAC* and ultimately a rejection of its principles. This I will call a fundamental critique. As an alternative for those less willing to follow the full distance, I also will offer a partial critique, indicating steps that might be taken to put right at least some of the unnecessary and immediate difficulties generated by *TRAC*.

The organization of this analysis is in four main parts. First, I will discuss basic forum allocation principles and *TRAC*'s specific contribution to them. Second, I will set forth a methodological critique of *TRAC*'s jurisdictional analysis, concluding that its approach is unduly one-sided, mechanical, and reductionist. Third, I will advance a substantive critique of *TRAC*, focusing both on its doctrinal holding and its general preference for exclusive appellate power. I will suggest that the doctrine is shot through with ambiguity and that the result is deeply questionable in light of major policies inhabiting this area of law. Fourth, I will set out alternatives to *TRAC*, based first on a fundamental critique and then on a partial critique of the opinion.

I. *TRAC*'s Contribution to Forum Allocation Principles

A. *General Principles*

We start with the postulate that the federal courts are courts of limited subject matter jurisdiction. They have the power granted to them by law.[9] The general subject matter jurisdiction statute, 28 U.S.C. §1331, assigns original jurisdiction to the federal district courts. Since administrative challenges raise federal questions,[10] they are ordinarily channelled to the trial courts of the federal system.

However, as is well known, Congress has altered the normal pathway to court in numerous settings by providing for initial review in the courts of appeal. The original model of this modification is the Federal Trade Commission Act of 1914.[11] That Act's legislative history makes clear that its aim was to avoid duplicating trial-type proceedings in both the agency and trial court. The court's judicial review function was described as one of reviewing issues of law, not of making findings of fact already reflected in records assembled before the agency.[12] This approach was generalized in the Administrative Orders Review Act.[13] The 1950 legislative history of that statute, which assigned the orders of numerous agencies to initial review by courts of appeals, speaks of the need to avoid making two records, one before the agency and another before the district court, and "thus going over the same ground twice."[14]

To be sure, these two statutes -- the FTC Act and the Administrative Orders Review Act -- were adopted at considerably different periods in American administrative history. The former represents the early stage of modern administrative development, well before major changes in our constitutional law during the New Deal that ultimately legitimated a broad-ranging administrative state.[15] The latter represents the period of procedural reform after World War II and the 1946 passage of the Administrative Procedure Act,[16] when the task of procedural review loomed large on the judicial horizon.[17] Nevertheless, they both share a common sense judgment that duplication of process to no purpose can and should be avoided, at least when an agency's orders have been entered on a record and are to be reviewed by a court. A corollary of this is to promote enforcement of federal law by cutting down the time needed for judicial review. Channelling cases immediately to courts of appeals also reinforces any existing patterns of appellate deference to the expertise of an agency.[18]

The largest problem emerging from so-called special review statutes has inhered in discerning their application to cases not definitively within or without the provision's terms. Should "order" be read to include a final agency rule, despite the traditional APA distinction between "orders" and "rules"? Should agency decisions relatively more inchoate than final "orders" nevertheless be read to be covered by statutes assigning orders to the courts of appeals? Such questions have occupied a large and continually growing body of doctrine.[19]

In recent years, given a willingness by courts to review a limited class of challenges prior to entry of absolutely final orders, a new question has arisen. When agency decisionmaking cannot be stretched to fit the concept of an "order" or other item to be reviewed initially in the courts of appeals, should a challenge to such decisionmaking be remitted to the general jurisdiction of the district courts, or should the courts of appeals still exercise jurisdiction as an initial matter? The case law has not been clear on this point. *TRAC* sought to make it clear by generally favoring court of appeals review in preliminary contexts not specifically covered by special review provisions.[20]

B. *TRAC's Analysis and Significance*

1. Statement of the Case

TRAC emerged from a dispute between the FCC and several not-for-profit public interest organizations about the pace of the FCC's determination whether the American Telephone and Telegraph Company (ATT) had to reimburse ratepayers for allegedly unlawful overcharges. The plaintiffs charged that the FCC had unreasonably delayed its decision. Plaintiffs petitioned the court of appeals for a writ of mandamus to compel the FCC to reach closure on the matter. The court of appeals raised the question of its subject matter jurisdiction,[21] asking the parties to address the following question:

> whether a petition to compel allegedly unreasonably delayed agency action properly lies before this Court or before a United States District Court, or whether these courts have concurrent jurisdiction, when any final agency decision in the matter would be directly reviewable in this Court.[22]

By framing the issue in this manner, the court focused attention on the fact that under the relevant statutes, a final order by the FCC would be subject to court of appeals jurisdiction. When that is the case, the court asked, who has jurisdiction in a doubtful situation over preliminary challenges?

Interestingly, only one of the two parties in this case expressed a comprehensive position on the jurisdictional issue. The FCC argued that the court of appeals had jurisdiction over the claim of unreasonable delay in this situation and that it was exclusive.[23]

TRAC's attorney did not elaborate a view beyond claiming that the court of appeals had jurisdiction.[24] The two intervenors in *TRAC* -- ATT and GTE Service Corporation -- agreed that the court of appeals had jurisdiction, but differed on the question of its exclusivity. GTE thought that there was exclusive power,[25] while ATT argued there was not.[26]

Faced with this array of positions, the court of appeals essentially adopted the FCC view, holding both that it had jurisdiction and that its power was exclusive. Regarding jurisdiction, the court noted that there was no final order over which it could assume power under the FCC's statutes. Delay is not tantamount to an "order", at least as viewed in *TRAC*. But this did not defeat the court's jurisdiction, as it proceeded under the All Writs Act, a venerable statute providing that "all courts established by an Act of Congress may issue all writs necessary "or appropriate in aid of their respective jurisdiction..."[27]

The All Writs Act argument rested on the idea that the court needed to assert power over the unreasonable delay claim in order to protect its future jurisdiction. As such, the court was acting "in aid of" its authority over final orders when it entertained this suit for preliminary relief. Although the court did not much elaborate upon this reasoning, it indicated concern that it might be prevented from ever reviewing a challenge to a final FCC order, assuming the FCC continued simply to delay and never entered such an order. To prevent ultimate frustration of its power of review, the court reasoned that it had warrant now to adjudicate the delay challenge.[28]

So far, nothing is extraordinary about *TRAC*. The use of the All Writs Act as a basis for jurisdiction, while not entirely uncontroversial,[29] seems reasonably settled and an appropriate use of judicial power.[30] What makes the analysis special is the further claim that the court of appeals' jurisdiction is exclusive. Although the court worked hard to tie this holding to existing doctrine, nothing should obscure the novelty of this aspect of *TRAC*.

The court started with the settled idea that when a final order is to be reviewed initially by a court of appeals because of some statutory provision to that effect, the otherwise-existing jurisdiction of the district courts is presumed to be cut off. This judge-made principle has the advantage of giving deference to a legislative judgment about forum allocation, and has been widely supported as such.[31]

But *TRAC* took another step that reflects something of a leap of faith. *TRAC* reasoned that it would be "anomalous" to conclude that district courts lack jurisdiction over final orders when courts of appeals have initial review power over such orders, but not also to hold that the district courts lack jurisdiction when the courts of appeals have authority under the All Writs Act in aid of their future jurisdiction.[32] It is almost as though the court analogized the All Writs Act as a source of appellate power to a special review provision assigning a case initially to the courts of appeals.

Why would a result contrary to *TRAC*'s be "anomalous"? To the court, the answer was that the broad policy reasons for consolidating cases in the courts of appeals are equally strong as to both final orders and preliminary challenges. More particularly, initial review by the courts of appeals, it was argued, can prevent unnecessary duplication of adjudicatory process, promote judicial economy, eliminate attendant delay and expense for the parties, and -- perhaps above all -- ratify the particular expertise of appellate tribunals in difficult administrative cases. It bears noting that the opinion's policy analysis is relatively brief, even cryptic, as if to suggest that exclusive appellate power is rather clearly the more reasonable course.[33]

TRAC pithily considered the implications of its ruling. In response to the claim that original review by the court of appeals might be legally inadequate because of that court's unfamiliarity with the taking of evidence, *TRAC* noted that the court can remand to the agency for factual development or it can appoint a special master.[34] For support, *TRAC* relied on a recent Supreme Court decision that took note of these powers of the courts of appeals in the review of final agency action.[35]

TRAC's jurisdictional holding was formulated as follows: where a statute commits review of final administrative action to the court of appeals, "any suit seeking relief that might affect the Circuit Court's future jurisdiction is subject to the exclusive review of the Court of Appeals."[36] *TRAC* noted that this holding was approved by the entire Circuit.[37]

2. *Importance of the Case*

TRAC is important on at least three levels. First, it dealt with a jurisdictional question that had not been resolved in prior case law.[38] *TRAC* came in the wake of numerous decisions that seemed to take for granted either district court [39] or court of appeals [40] jurisdiction over challenges to agency delay or inaction, but did not expressly settle the jurisdictional issue. *TRAC* found in this divergent set of practices a "state of disarray."[41] As an attempt to resolve it, *TRAC* inevitably has gained significance in the doctrine.

Second, *TRAC*'s own terms and implications are extremely wide-ranging. Its holding is not limited to FCC cases, to delay cases, or to adjudications. Moreover, there is nothing particularly special about the FCC statutes involved in *TRAC* that would lead one to limit the decision to certain statutory contexts. The statutes speak broadly of "all final orders" and "any order," much in the language of a host of other special review provisions.[42] Furthermore, later cases have applied *TRAC* to a variety of settings in which many different types of challenges to agency decisionmaking have been made in preliminary contexts.[43] These include constitutional challenges such as to alleged agency bias and prejudgment,[44] procedural challenges under statutory provisions,[45] and substantive challenges to an agency's authority [46] as well as challenges under the "arbitrary" and "capricious" standard of review.[47] The body of post-*TRAC* caselaw is continually expanding.[48]

Third, *TRAC* is important for its method of analysis of forum allocation questions and for the implications of its holding for judicial review generally. I will turn to those two topics, respectively, in the following two sections.

II. A Methodological Critique of *TRAC*

In this section, I will focus on the methodological side of the forum allocation debate represented by *TRAC*. To be sure, no absolute distinction should be drawn between a decision's method of reasoning and its substantive result, for often the result is only as compelling as the reasoning leading to it. I will be asking whether *TRAC*'s mode of argument satisfies basic criteria of methodological completeness, or whether it misses important factors, oversimplifies relevant considerations, or without overt justification changes the terms of debate in ways that seem problematic. After discussing general principles, I will suggest that *TRAC* does suffer from the above-mentioned deficiencies.

A. *General concepts*

Because forum allocation questions are matters of statutory construction, the well-recognized tension between "formalist" and "purposive" modes of construction should be expected to play a major role in this context, as indeed it does. In the simplest cases, a "plain language" rendering of a jurisdictional statute may suffice.[49] Yet in more difficult cases, courts tend to move to a purposive analysis that focuses on the aims or objectives, stated or implied, of a particular jurisdictional allocation. This means that they are concerned with assessing the ends that would, or would not, be advanced by assigning original review to one or the other level of the court.[50] On a purposive view, the language of statutory allocations is frequently supplemented by judicial assessments of the institutional wisdom of different results as filtered through the courts' understandings of the aims served by judicial review.[51]

A prime example of the importance of purposive reasoning about jurisdiction is found in modern cases interpreting statutes calling for the review of agency "orders," as applied to the review of rules. Traditionally, a formalistic argument was made that the review of an "order" should not be seen to encompass a rule on the ground that the word "order" denotes something different from "rule." This distinction rested partly on the general contrast in the Administrative Procedure Act between rules eventuating from rulemaking and orders that complete adjudications.[52] This distinction was buttressed by the notion that appellate review of an order would follow a quasi-judicial proceeding and could proceed on the basis of a record providing the decision's underpinnings, whereas appellate review of rules would be more difficult because they are not necessarily grounded on complete and tested records.[53]

This formalistic view has come under attack in the D.C. Circuit and elsewhere on the basis of straightforwardly purposive legal reasoning.[54] Courts have come to emphasize that the aims of appellate review apply at least as much, if not more so, to rules as to orders. Rules, after all, are less likely to depend on the sort of highly particularized factual assessments that underlie adjudications. There is thus less reason to suppose that the special competence of district courts with factual inquiries would be important with respect to the review of rules.

Furthermore, courts have observed that rules must rest on a "concise" general statement of basis and purpose under notice-and-comment requirements.[55] That should be adequate in most cases, courts have reasoned, to provide a reference point for judicial review. And if it is not, they have noted, courts can remand to the agency for further explanation or other supplementation of the record.[56] Should that occur, all that would be lost would be time, and the role of the courts of appeals as reviewing tribunals would be preserved.

Accordingly, the modern order/rule cases confirm that courts often look beyond the literal language to the underlying purposes of direct review statutes. As post-realists, courts have fashioned an approach to jurisdictional inquiry that has the potential of being practical and sensitive to competing policies arising in particular cases.

B. *TRAC's Method*

It remains to ask where *TRAC* sits within the modern tradition of purposive jurisdictional analysis. To answer that question, I need first to distinguish between two sorts of purposive analysis. These may be called "abstract" and "complex" purposive inquiry. The differences between them are important because they show that purposive reasoning can be carried out abstractly and formalistically, or it can be applied with complexity and attention to the full range of competing policies informing a doctrinal area. In my view, the weakness of *TRAC*'s method is that it adopts the abstract purposive approach. It is thereby subject to criticism as incomplete, over-simplified, and reductionist.

To make this argument, I will first set out more fully the contrast between the two types of purposive analysis. I will then contend that *TRAC* embraces the abstract mode of such inquiry. I will highlight the weaknesses of *TRAC*'s approach by contrasting it with examples of complex purposive reasoning about jurisdiction.

1. Two Types of Purposive Analysis

Again, the chief contrast I wish to stress is between abstract and complex purposive analysis. Abstract inquiry is exemplified by looking with considerable generality at the objectives served by original court of appeals review, and by applying those objectives immediately to situations without closely examining the potentially distinguishing features of the underlying situations that give rise to cases. A complex inquiry is also purposive in that it concentrates on the aims advanced by different allocational results allowed by a statute. Yet it is distinct because it attends closely to the context in which a particular jurisdictional issue arises. It seeks to apply with care the competing policies that are associated with multiple features of administrative problems and that point for and against appellate review in concrete cases.

Abstract purposive reasoning about jurisdiction does have certain advantages. In particular, such an approach significantly simplifies legal debate. After all, it is relatively easy for a court merely to put to the forefront of analysis the desire to vindicate the presumed, even if not always stated, aims advanced by direct appellate review. These considerations naturally tend to support the broad-scale consolidation of actions in the courts of appeals.

To elaborate, abstract purposive argument invokes such objectives of consolidation as reducing the litigation delays suffered by parties in two-tier review (assuming an appeal is to be taken).[57] It similarly seeks to avoid whatever waste of judicial resources attend two-tier review.[58] Furthermore, consolidation in the appellate tribunal can be said to lessen the possibility of conflicting judicial applications of jurisdictional principles -- for the courts of appeals can harmonize the law of a circuit in a way that district courts cannot.[59] Also, consolidation can be said to serve the goal of channelling administrative cases to courts that have special expertise resulting from repeated exposure to administrative cases, as well as the special authoritativeness attaching to multi-member panels.[60]

A single-minded emphasis on such abstractly-stated aims surely would simplify the doctrine. Yet this is not necessarily a virtue. Abstract purposive reasoning stresses the goals of consolidation in the appellate courts while conceiving of those aims in the broadest possible terms, without recognizing that they are situated in a complex fabric of competing ideas that often point in different directions.

In particular, notwithstanding the general arguments noted above in favor of consolidating review in appellate tribunals, countervailing policies counsel restraint and caution. A major counter-policy is that appellate tribunals are particularly overloaded in their dockets. Also, precisely because they must meet in threes, they have less ability to expand effectively to meet the challenge of a burgeoning workload.[61] For issues of relatively less legal or policy importance in our administrative system, it appears doubtful that the time and resources of appellate courts should necessarily be drawn upon initially. To be sure, no litigant believes that his or her case is of limited legal or policy importance. Yet that should not foreclose our making general distinctions among types of cases based on our awareness of such differences.[62]

Furthermore, appellate tribunals do have certain special qualities, including collegial and deliberative decisionmaking, that attune them to certain types of issues, principally including major questions of law arising in administrative settings. But these same qualities may not suit them as well for other matters, including those involving the development of an agency record or factual inquiries that may have to precede the application of law to a case.[63]

In all, it is unduly one-sided to engage in an abstract application of policies favoring appellate consolidation without carefully weighing them in relation to competing aims. What is called for instead, in my view, is a complex purposive inquiry into jurisdictional questions.

2. *TRAC's* Use of Abstract Purposive Reasoning

Unfortunately, *TRAC* exemplifies abstract purposive reasoning about jurisdiction. This point becomes clear as one traces *TRAC's* argument for exclusive appellate review.

TRAC's initial point of reference in its jurisdictional discussion is the following question: which level of court would review the agency action if and when it becomes final? In *TRAC*, the FCC was in the midst of an administrative process that, if it were completed, would eventuate in a final order. The key question for *TRAC* was thus which level of court would review the final order itself? Since it would be reviewable exclusively in a court of appeals, *TRAC* reasoned that the preliminary challenge also should be reviewable exclusively in a court of appeals.[64]

As noted earlier, *TRAC* seeks support in a well-established precept concerning the exclusivity of appellate review in a situation different from *TRAC's*.[65] The traditional precept is that even when a statute has not specifically provided that original appellate power is exclusive, but when the statute vests review of final agency decisions in the courts of appeals, it thereby cuts off original jurisdiction in other courts over such actions.[65] This precept has achieved wide application. The leading case dealing with it in the Supreme Court is *Whitney National Bank v. Bank of New Orleans and Trust Co.*[66] In that decision the court concluded that statutes pertaining to the Federal Reserve Board, which assigned the Board's decisions to direct appellate review, ousted the district court of jurisdiction.

In *Whitney National Bank*, certain banks had brought an action seeking a district court order barring the Comptroller of the Currency from issuing a certificate permitting a new bank to open. The statutes provided both for the Comptroller to issue a certificate and, under other provisions, for the Federal Reserve Board to review the matter. The latter's decision was to be reviewed exclusively in the courts of appeals. Given this statutory design calling for a Board decision and exclusive review of it by an appellate tribunal, the Supreme Court concluded that the district court was ousted of jurisdiction. In the Court's eyes, to permit the district court to address the matter would undercut the statutory scheme of Board decision followed by appellate review.[67] Moreover, general policies favoring consolidation of review in the courts of appeals were seen to support such an interpretation. Accordingly, channelling the action to the court of appeals was said to prevent unnecessary duplication and possibly conflicting judicial decisionmaking.[68]

Numerous decisions since *Whitney National Bank* have confirmed the exclusivity of appellate power when a statute provides for direct review over final agency actions.[69] Yet it is worth repeating that this principle has evolved in relation to final administrative decisions -- which, as noted earlier, are fundamentally distinct from the preliminary setting of *TRAC*. *TRAC*'s extension of the exclusivity principle ultimately rests on an abstract purposive argument about the aims of consolidating actions in the courts of appeals. Indeed, the general objectives discussed in a different context in *Whitney National Bank* -- avoidance of duplication and potential judicial conflict -- are central to *TRAC*'s rationale. As *TRAC* puts the basic point, such "compelling policy reasons" militate in favor of exclusive appellate review in *TRAC*'s context.[70]

A key problem with *TRAC*'s abstract reasoning is that it lacks any sure footing in the FCC statute whose presence seems central to the exclusivity conclusion. That statute refers simply to "all final orders" and "any order" of the agency.[71] Whatever else might be in doubt about *TRAC*, delay is not treated as within the normally understood range of meanings attributable to "order." Indeed, *TRAC*'s reliance on the All Writs Act as the basis of its power shows that the court is not seeking to stretch the meaning of "order" to include delay. The real thrust gained from the FCC statute is its supposed support for the claim of the exclusivity of jurisdiction otherwise derived. And that claim, once more, rests on abstract purposive reasoning.

In fact, *TRAC*'s key support is a mere assumption that it would be "anomalous" not to realize the purposes of direct review in the context of delay, given that those purposes would be realized by appellate review of a final order.[72] This assumption ignores any differences between challenges to formally final actions, on the one hand, and claims relating to preliminary matters, on the other hand. *TRAC*'s assumption is especially troubling in view of the importance of carefully applying the competing policies that underlie jurisdictional questions to the particular contexts giving rise to them.

Why exactly is it so "anomalous" to hold both that a final agency order is to be reviewed exclusively in the court of appeals and that a preliminary matter is not to be so reviewed? There is nothing illogical about such a contrast. Moreover, the two contexts are legally distinguishable. Congress had not spoken specifically about non-final matters such as delay, but it had spoken about final action eventuating in an order.[73] Is another distinction really needed?

TRAC's one-sidedness becomes patent as one recognizes that its analysis would always support consolidation of review in the courts of appeals. In fact, *TRAC*'s argument has a distinctly tautologous character. After all, reasoning based solely on the aims of consolidation at the appellate level will inevitably tend toward consolidation at the appellate level, regardless whether the various purposes behind allocations will truly be served. Given that jurisdictional statutes in particular are to be read with special care,[73] the analytical reductionism involved in *TRAC* should give one serious pause.

As to *TRAC*'s policy arguments, to say that they call automatically for the collapse of any contrast between preliminary and final matters in relation to exclusive appellate review is to disregard practical differences between the two settings. It is not unlikely that in a preliminary context such as in *TRAC*, the record relevant to a challenge will be relatively less developed and available than in the context of final agency action. The discovery and fact-finding capacities of a trial court may be especially useful for addressing a preliminary dispute. There is thus a reasonable basis for differentiating between the review of preliminary and final actions. Quite simply, the former may be more appropriately reviewed by a district court as an original matter.[74]

A supporter of *TRAC*'s reasoning might respond by abstractly invoking the purposes of consolidation in appellate courts that are arguably furthered by *TRAC*.[75] Once again, this response is less of an argument than a conclusion. Moreover, on closer analysis, those very purposes may not fully be served by *TRAC*'s approach. Take the aim of respecting the special expertise of the appellate courts. The idea is that when a relatively smaller group of appellate judges repeatedly reviews certain types of agency orders, the judges develop a degree of familiarity with the agency, its mission, and its limitations, and that such "expertise" is a value to be preserved.[76] Whatever the weight of this rationale for appellate review, the rationale seems strained when applied to preliminary challenges that may well involve action, inaction, or delay that is not fully grounded in an agency record. In such instances, the "expertise" argument may actually cut the other way, in favor of trial-court-supervised inquiry prior to the application of norms of law to a given situation.[77] At the very least, different types of judicial "expertise" need to be analyzed, whereas *TRAC* limits its discussion to matters of expertise that are peculiar to courts of appeals.

To summarize, my point is not to cast doubt on purposive construction of forum allocation provisions. Rather, I seek to call into question the unduly abstract and one-sided purposive analysis displayed in *TRAC*.

3. The Contrast between *TRAC* and Complex Purposive Reasoning

Having viewed *TRAC* as an example of abstract purposive reasoning about jurisdiction, it remains to show what a more complex and sophisticated analysis would look like. As it happens, we have leading examples of such an approach. Their insights emerge from the notion that since original jurisdiction in our federal system normally resides in the district courts, one requires a reasonably compelling justification for departing from such a scheme. The justifications turn on interpreting relevant statutes in view of the respective competencies of the district and appellate courts.

The most prominent representative of such an approach is a report on forum allocation prepared by Professors David Currie and Frank Goodman [78] in the mid-1970's for the Administrative Conference of the United States.[79] Currie and Goodman engaged in a complex assessment of the appropriateness of appellate, as opposed to trial, review. It assessed the respective mix of legal and factual issues in various types of cases, the importance of the issues raised, and the respective fact-finding as opposed to law-resolving capacities of the reviewing courts.

Currie and Goodman particularly distinguished on-the-record decisionmaking, informal rulemaking, and informal adjudication. After a detailed analysis they concluded, with respect to on-the-record decisionmaking, that appellate review is sensible as a general matter. After all, in these cases there is a fully developed agency record.

As to "informal" notice-and-comment rulemaking involving issues of legal importance likely to end up in a court of appeals, Currie and Goodman also concluded that direct appellate review is presumptively appropriate.[80] They considered that, in such cases, there generally is no need for extensive fact-finding. Also, such cases have a primarily legal significance, and issues of law are traditionally suited for resolution by the courts of appeals.[81]

However, with respect to "informal" adjudication -- the vast residual category into which the bulk of administrative action falls -- Currie and Goodman concluded that the absence of a formal administrative record justifies a presumption in favor of initial district court review.[82] As to informal adjudications involving no significant fact finding burden, the authors indicated that direct appellate review might in some instances be appropriate.[83]

Although Currie and Goodman's study concentrated on the review of final -- not preliminary -- agency action, its balancing of an array of competing factors shows how one would engage in the sort of complex analysis missing from *TRAC*. In adopting a recommendation based on Currie and Goodman's report, the Administrative Conference confirmed the importance of a complex approach.[84]

The Administrative Conference agreed with Currie and Goodman that formal adjudications and formal rules generally should be made directly reviewable by the courts of appeals.[85] The Conference allowed for district court review of formal administrative action when it is of a type that "rarely involves issues of law or of broad social or economic impact warranting routine review by a multi-member court" and when district court review would "significantly reduce the workload of the appellate courts."[86] The latter condition -- significant reduction in the workload of appellate courts -- depends on there not being frequent appeals from district court decisions in the area.[87]

With respect to "informal" rules, the Conference concluded that direct appellate review would be appropriate when an initial district court decision about the rule's validity would ordinarily be appealed or "the public interest requires prompt, authoritative determination of the validity of the rule."[88]

With regard to informal actions other that rules, the Conference recommended that they generally should be reviewed in the first instance by the district courts. This presumption would be overcome only if all of the following conditions obtained: that the actions typically involve "issues of law or of broad social or economic impact"; that they do not usually require "an evidentiary trial at the judicial level to determine either the underlying facts or the grounds on which the agency based its actions"; and that they are either few in number or, if numerous, "would in most cases be likely to reach the appellate courts eventually" by appeal from district court judgments.[89]

To summarize, the analyses of Currie and Goodman and the Administrative Conference confirm the importance of a textured, balanced investigation into competing considerations that bear on forum allocation. Without even raising the question of how the factors should be balanced in *TRAC*, one can see that by contrast to these earlier approaches, *TRAC*'s method is remarkably narrow, one-sided, and abstract. Its doctrinal importance should not obscure the character of its reasoning.

III. A Substantive Critique of *TRAC*

In this section, I will focus on the substantive side of the forum allocation debate represented by *TRAC*. By "substantive" I mean simply the result reached and its implications for courts, private litigants, and agencies, as well as its broader associations with ongoing debates about judicial review. I will be asking whether *TRAC* has achieved a workable resolution of the crosscurrents in the law, or whether it instead represents an unstable compromise subject to continued challenge in light of contending values, interests, and visions relating to judicial review. I will suggest that the latter is the case.

A. *Doctrinal Implications: The Weaknesses of TRAC's Holding*

I will first discuss the central weaknesses of *TRAC*'s doctrine. These are of two main types. First, *TRAC* stretches so far beyond prior law as to contradict established principles of forum allocation. Second, as a new approach, *TRAC*'s holding raises serious questions about its scope that it does not begin to answer. I will consider each matter in turn.

1. *TRAC* and Established Principles

A central precept regarding forum allocation is that when Congress is silent or otherwise has not indicated a design to channel a case to the courts of appeals, the general federal question jurisdiction statute applies.[90] This means that in the absence of a special review provision, the federal district courts retain initial jurisdiction over administrative actions.

TRAC does not follow this precept. There is, after all, no doubt in *TRAC* that no special review provision was thought specifically to apply. Jurisdiction rested on the All Writs Act, which does not contain a special review provision.[91] Accordingly, where such a provision does not apply, the established doc-trine would have channelled the case to the district courts under 28 U.S.C. §1331.

TRAC's main response to this basic point is that the policies of appellate review still seem pertinent.[92] It is well-established, however, that applicable statutory language generally governs.[93] *TRAC* may be seen to have proceeded in the face of established principles.

2. *TRAC* as a New Statement of Doctrine

As a new statement of doctrine, *TRAC* suffers from deep ambiguity. Let us, for analysis' sake, break down *TRAC*'s doctrine into three parts. First, if a final action under an agency's statutes would go to the courts of appeals, then, second, a preliminary challenge to activity under the statutes also will go to the courts of appeals if, third, relief in relation to the challenge might affect the appellate court's future jurisdiction. Each of these parts has generated considerable confusion.

To be sure, any leading decision is likely to foster some debate about its details. My point is not that. It is that *TRAC* has a fundamentally ambiguous holding that leads to serious and unresolved questions about its applicability and reach.

(a) Where Do Final Actions Go?

The first aspect of *TRAC*'s doctrine noted above relies on other law to determine where a final agency action should be reviewed. This question, however, is often not easily resolved. The cases are full of controversies about the court in which final actions not expressly covered by some special review provision should be brought.[94]

Moreover, *TRAC* wrongly assumes that in every case, after sufficient analysis, one should be able to reach a judgment about where a final action -- when it occurs -- should be reviewed. That is not possible when a statute treats different types of final actions differently, and when the plaintiff sues the agency before the case has matured sufficiently to indicate which type of final action is to be expected.

For instance, the Occupational Safety and Health Administration may decide to issue "standards," which are reviewable in the courts of appeals, or it may issue "regulations," which are reviewable in the district courts.[95] If a challenge is brought before this decision has been made, it will not be possible to predict where a final agency action should be reviewed. Such jurisdictional uncertainty also may occur as to preliminary challenges involving Food and Drug Administration approval of new drug applications under the Food, Drug and Cosmetic Act.[96] When the FDA refuses to approve an application, the statute authorizes the applicant to appeal directly to the courts of appeals.[97] However, this provision does not apply to parties challenging FDA approval of a new drug application, who thus are to proceed in the district courts.[98] A preliminary challenge could be brought before the ultimate jurisdictional pathway has been established. In such cases, *TRAC*'s holding requires a court to make a premature jurisdictional analysis based on speculation about the nature of the ultimate agency action in order to determine whether it can hear the preliminary challenge to agency decisionmaking.

(b) What does it mean to suppose that a preliminary challenge is "under" an Agency's Organic Statute?

The second aspect of *TRAC*'s doctrine is the following: *TRAC* applies to preliminary challenges brought under statutes as to which a judgment can be made concerning where a final agency action should be reviewed. Read broadly, this is an innocuous rendition, for any agency action must be authorized by its organic statutes and therefore be "under" those statutes. However, read more narrowly, this idea raises the possibility of eliminating from *TRAC*'s scope challenges brought "under" other norms, such as constitutional challenges that do not specifically allege a violation of an agency's organic statutes.

This very possibility has been the focus of a heated controversy about *TRAC*'s scope. In fact, in *Ticor Title Insurance Co. v. FTC.*,[99] the district court held that constitutional issues are not covered by *TRAC*'s exclusivity holding.

In *Ticor*, the plaintiff challenged the FTC's enforcement action against it. The plaintiff argued that the agency's activity violated the principle of the separation of powers. In particular, the plaintiff claimed that the heads of agencies with enforcement powers like the FTC's must, as a constitutional matter, be executive officers who are subject to removal at will by the President. The FTC's officers, like those of other so-called independent agencies, are not so removable.[100] Thus, the plaintiff contended that the agency's basic authority to act was lacking and that the proceeding against it should be ordered terminated.[101]

An initial issue in *Ticor* was whether the district court had jurisdiction to hear the matter. The district court concluded that even though *TRAC*'s language is broad, it should not be applied here because the suit raised a constitutional question. The district court reasoned that *TRAC*'s real concern was to assure that when a statute allocates cases to the courts of appeals, the "class of claims covered by the statutory grant of review power" should be the exclusive preserve of those courts. This purpose was considered not to encompass purely constitutional challenges.[102]

In an effort to clarify its meaning, the district court drew a line between challenges dealing with "the manner in which agency process was implemented" -- which it deemed to fall within *TRAC*'s purview -- and separate constitutional claims.[103] *Ticor* suggested that it would "strain credulity" to read *TRAC* in the broadest possible terms to preclude district court review in all cases in which a challenge is raised about some statute under which final action would be reviewed exclusively in a court of appeals.[104] Such a reading would in the district court's view "cut a swathe through this Court's jurisdiction akin to Sherman's march through Georgia."[105]

Ticor's effort to limit *TRAC*'s scope raises obvious issues. First, the limit is not stated in *TRAC* itself. Second, the distinction between challenges dealing with "the manner in which agency process was implemented" and constitutional challenges may often be tenuous at best. For example, what should be done with a bias claim, which is a species of constitutional due process argumentation but also is directed at the reliability of agency process? Third, what happens when a constitutional claim is joined to a statutory claim that all concede could trigger *TRAC*?

Despite these questions, *Ticor*'s interpretation has borne fruit. In *First Commodity Corporation v. Commodity Futures Trading Commission*,[106] the U.S. District Court for the District of Massachusetts followed it. In that case, a commodity broker challenged a reparations program administered by the CFTC. The plaintiff made two arguments: first, that the agency was so biased as to have violated due process and, second, that the reparations program contravened Article III on the theory that it effectively gave judicial power to an entity which is not an Article III tribunal.[107] The district court bifurcated the two claims. The due process/bias claim was held to be within the exclusive domain of the court of appeals following *TRAC* and its companion case, *Air*

Line Pilots Association v. CAB.[108] The Article III claim, however, was held to be distinguishable. It was seen as a "separate" constitutional claim that, under Ticor's reasoning, should not be included within the exclusive power of the court of appeals.[109]

This effort to place some clear limit on *TRAC*'s scope has not won unanimous approval. Another judge on the U.S. District Court for the District of Columbia, in *Jamison v. FTC*,[110] concluded that constitutional claims involving the first and fifth amendments fell within *TRAC*'s ambit. *Jamison* gave two reasons for rejecting Ticor's reasoning. First, *Jamison* stressed that due process/bias claims already had been held to be covered by *TRAC*. That was seen to indicate that the weight of authority had rejected a hard-and-fast line between constitutional and statutory claims.[111] Second, and more centrally, *Jamison* underscored that making a constitutional claim exception to *TRAC*'s jurisdictional principles would "cripple the purposes of the *TRAC* doctrine."[112] All that a party would have to do to avoid *TRAC*, on one view, would be to attach a constitutional claim to the argument. This expedient, *Jamison* urged, is far too easy and obvious a way to gut *TRAC*'s purpose of allocating review decisively to the court of appeals.[113]

One might have hoped for clarification whether assigning constitutional claims in preliminary settings to appellate courts should be seen to do to district courts what Sherman's march did to Georgia, or, alternately, whether a failure to so assign cases would unacceptably cripple *TRAC*. Yet the D.C. Circuit avoided taking a clear position when it decided *Ticor* on appeal and on other grounds affirmed the lower court's judgment.[114]

Judge Edwards was careful to note that, given his disposition of the case on exhaustion grounds, he did not need to pass on contentions relating to a "constitutional" exception to *TRAC*'s application.[115] He underscored that *TRAC* itself did not mention the matter.[116] The issue was left open by his statement that "I need not stop to consider here whether a constitutional challenge could ever be so separate from the underlying agency proceedings that the district court would have jurisdiction under section 1331."[117] He took some comfort from the expectation that a "separate" constitutional challenge would not likely be subject to review in any event prior to the conclusion of agency proceedings, by which time any exclusive review statute would be directly applicable.[118] In contrast, in a separate opinion in the *Ticor* appeal, Judge Green took the opportunity to agree with the district court's views about *TRAC* and to conclude that challenges to the constitutionality of an agency's enabling statute should not be seen to fall within that decision's ambit.[119]

(c) What Does *TRAC*'s "Might Affect" Qualifier Mean?

The third element of *TRAC*'s doctrine noted above is repeated in each of the court's summations of the holding: a preliminary challenge otherwise meeting *TRAC*'s conditions is covered by *TRAC* if relief in relation to it "might affect" the court's future jurisdiction.[120] One may be tempted to suggest that this "might affect" qualifier is a throw away, on the theory that the court is just trying to make sure there is some reason to apply exclusive jurisdiction. However, therein lies the rub: what exactly is the reason? Unless this aspect of *TRAC* is clear, *TRAC*'s rationale will be very difficult to understand.

To be sure, the "might affect" qualifier could have no real meaning. On this reading, the "might affect" test is no test at all. An alternative possibility is that the "might affect" concept was intended to have meaningful content. But the opinion is so vague about this point that it is difficult to discern what exactly that content is.

The first possibility derives from the remarkable generality of *TRAC*'s holding. On its own terms, without placing it in context or otherwise limiting it to the purposes for which *TRAC* was written, its holding could be read to cover any preliminary challenge to agency behavior so long as final administrative action would be subject to exclusive appellate review. After all, in virtually any contest, a district court might take some action that could change the position of the parties, alter the agency's plans or proceedings, or otherwise transform events in ways that could have some effect on what the court of appeals would be in a position to decide if and when the matter comes to that court.

A chief problem with this possibility is that it disregards the court's textual statement of the reasons for holding the way it did. The court clearly indicated that it sought to "protect" the jurisdiction of the court of appeals in the face of some risk that its jurisdiction might be seriously jeopardized.[121] Thus, *TRAC* quoted another decision to the effect that when a matter is within the jurisdiction of a higher court, a writ "may issue in aid of the appellate jurisdiction *which might otherwise be defeated*." (emphasis added)[122] Moreover, *TRAC* stated that because the statutory obligation of a Court of Appeals to review on the merits may be defeated by an agency that fails to resolve disputes, a Circuit Court may resolve claims of unreasonable delay *in order to* *protect its future jurisdiction.* (emphasis added)[123] These passages indicate that the court sought to "protect" against the "defeat" of appellate power. To be faithful to the court's stated rationale, it seems necessary to determine in which cases the rationale would apply, and not simply to assume that it would apply in every case.

Therefore, the second possibility seems the more reasonable one: that *TRAC* sought to limit the scope of its holding with respect to preliminary actions in some meaningful and ascertainable way. The question then becomes whether the attempted limitation holds up under analysis.

Again, the main limit on the holding seems to be that *TRAC* is seeking to protect against the defeat of appellate jurisdiction altogether. This construction is consistent with *TRAC*'s reliance on a leading Supreme Court authority applying the All Writs Act to preliminary settings, *Federal Trade Commission v. Dean Foods Company*.[124] In that case, the FTC had initiated administrative proceedings under the antitrust statutes in order to prevent the consummation of a merger agreement among certain competitors in the sale of packaged milk. The agency sought a judicial order to maintain the status quo until the agency could determine the legality of the proposed merger. The court of appeals dismissed the petition on the ground that the FTC had not entered a cease and desist order, and therefore the court had no authority to assert review power over the case.[125] The Supreme Court reversed.

For the Supreme Court in *Dean Foods*, the All Writs Act provided a basis for the court of appeals to act in order to protect its potential jurisdiction over a future order by the FTC.[126] Specifically, the Act was seen to support appellate jurisdiction on the ground that declining to exercise power might alter the effectiveness of judicial review at a later time.[127] This was so because if the proposed merger were allowed to go forward, any subsequent agency order against it might be able to be reviewed in only a limited fashion by the court of appeals. This assumed, for instance, that certain of the corporate assets might already have been sold by the time of judicial review. In effect, the Court thought that waiting might leave the court of appeals with a fait accompli. For this reason, the Supreme Court upheld the court of appeals' jurisdiction to hear the matter in aid of its ultimate power of review.[128]

As construed in *TRAC*, *Dean Foods* is seen to support the proposition that a court can proceed under the All Writs Act if the alternative of not acting might result in frustration of the court's review power.[129] As noted earlier, *TRAC* considered that this principle applied directly to its own situation of allegedly unreasonable agency delay. The idea was that if the FCC in fact was delaying unreasonably, and if it continued to do so without redirection by the court, then there would be the possibility that no final order would ever be issued. This could ultimately defeat the prospect of direct appellate review of agency action. To avert that possibility, the court reasoned that it was necessary or appropriate for it to assert jurisdiction over the matter.[130]

If one views the preceding line of reasoning as lending some meaningful substance to the "might affect" language in *TRAC*'s exclusivity holding, one can argue that *TRAC*'s "might affect" test is appropriately constrained and sufficiently clear. After all, under such a construction the court of appeals could be seen simply to be claiming exclusive prerogatives in cases in which, if it did not act, it might be utterly foreclosed from acting in the future. Taken on its own terms, that sort of justification of exclusive appellate power hardly seems grasping or unlimited.

However, things are not so simple. While it is true that the concepts quoted above appear in *TRAC*, it should not be thought that they offer a simple answer to any concern about the apparent vagueness and grandiosity of *TRAC*'s exclusivity holding. To the contrary, upon analysis a "protect against the defeat" gloss on *TRAC*'s exclusivity formula suffers from serious problems.

The difficulties with this limiting gloss become clear when one presses the notion that the exercise of judicial power now is needed to "protect" against the "defeat" of appellate jurisdiction later. Why exactly is that the case? Is it not true that in most situations, if the courts of appeals do not exercise power, the district courts will retain general federal question jurisdiction?[131] And if a district court decides a case, might not the losing party appeal the decision to a court of appeals? The only real question about this alternative method of reaching the court of appeals involves the intentions of the losing party. To be sure, if there is no appeal, the appellate court cannot exercise power. But that means simply that the inability to exercise appellate power would turn on a choice of the parties not to seek review. That is, of course, the usual reality, and it hardly seems to be the sort of "defeat" of appellate authority that *TRAC* has in mind.

Is there any reason why this obvious alternative to direct appellate review is insufficient? To make a case that it is, one would have to establish that direct appellate review is somehow distinctly superior to ordinary review on appeal from a district court judgment. If that were the case, then one could claim that frustration of direct review is itself the point -- and that the availability of review on appeal is not as satisfactory. However, such an argument is at best tenuous.

From the point of view of the courts of appeals, there is very little difference in their role in relation to agency decisionmaking in the two contexts of immediate review and review on appeal. It might be suggested that differences do exist in the standards of review of issues of fact involved in agency, as opposed to judicial, decisionmaking. Yet any verbal distinctions seem minimal in their impact.[132] Moreover, it can be argued that appellate courts have slightly more leeway with respect to the findings of trial judges than they do with respect to the findings of agencies, as to which special administrative expertise may be presumed to have played a role.[133] If that is the case, then the ordinary route to appellate review from the district courts might well give the appellate courts more -- or certainly not less -- leeway than direct review straight from the agencies. In any event, any small differences in the role of the courts of appeals that may inhere in appellate review of district court judgments about agency actions -- as opposed to appellate review directly of agency actions -- do not provide a basis for the claim that direct review is somehow so superior that it must be "protected" at all costs.

Furthermore, if the argument is that direct appellate review is superior to ordinary review on appeal because the former vindicates all of the purposes normally associated with it, then there is a serious problem of tautology. One cannot convincingly say that the reason to protect direct appellate review at all costs is because that would vindicate the purposes of such review. While that is no doubt true, it is equally true, as noted earlier, that there are countervailing purposes to be considered. Surely the task for analysis is to look at the entire configuration of policies without simply prefiguring the result in one's premises.

One surely would wish that this confusion in *TRAC* had been addressed satisfactorily in post-*TRAC* case law. However, the doubts about what "might affect" means run so deep that later cases simply compound them.

In particular, the post-*TRAC* cases confirm that *TRAC* is not confined to situations in which the exercise of appellate power is somehow necessary to prevent the total defeat of the court's ultimate jurisdiction. Several decisions involve situations, as in *TRAC* itself, in which plaintiffs asked district courts to issue orders that would precipitate agency decisionmaking which, if it continued to fruition, would lead to final agency actions reviewable exclusively in the courts of appeals. In these cases, courts, including the D.C. Circuit, have opined that *TRAC* shifts the action to the exclusive domain of the courts of appeals. This has been the result even though what the district courts had been asked to do cannot reasonably be characterized as preventing the courts of appeals from hearing challenges to agency actions. Indeed, the district courts were asked to initiate a chain of events that would, if culminated, lead directly to court of appeals review. Yet this, too, has been commonly seen to fall within the scope of *TRAC*'s "might affect" test.

Thus, in *Independent Bankers Association v. Conover*,[134] the district court was asked to direct the Federal Reserve Board to decide whether to approve the charters of certain banks. The district court reasoned that it had no power to issue such an order on the ground that it "might affect" the court of appeals' future jurisdiction. This was so because, in effect, the court would be ordering the Federal Reserve Board to take action, and under the relevant statute such action was reviewable exclusively in the court of appeals.[135] Likewise, in *International Union, UAW v. Donovan*,[136] the plaintiffs sought an order requiring the issuance of a health and safety standard. The D.C. Circuit concluded that this challenge was within its exclusive review power. The court considered that because an order requiring the agency to issue a standard would require action precipitating direct review, the challenge fell within the "might affect" test and so *TRAC* applied.[137]

In addition, the "might affect" test has not been limited contextually to situations in which the plaintiff has sought an order that would precipitate action to be directly reviewed. It has been extended to cases in which the district court has been asked to alter the processes of decisionmaking -- such as by requiring a hearing or recusal of an official -- well before finalization of agency action that would be reviewed by an appellate court.

One example of this extension of the "might affect" concept is *Community Nutritional Institute v. Young*.[138] There the plaintiff sought an order of the district court requiring a hearing. The court of appeals reasoned that the district court never had jurisdiction, even prior to the agency's issuance of a final denial of the hearing request, on the ground that a procedural challenge to ongoing agency process "might affect" the court of appeals' jurisdiction.[139]

Another example is *TRAC*'s companion case, *Air Line Pilots Association v. CAB (ALPA)*,[140] which involved a bias claim as well as a delay claim against the agency. *ALPA* opined that the bias claim "has equal power" to affect the future jurisdiction of the appellate court as does the delay claim.[141] However, there is a difference. If a delay claim such as in *TRAC* is redressed, the court's order will dictate agency action that would be subject to direct appellate review. If a bias claim such as in *ALPA* is redressed, the court's order will call for recusal of an official, but will not itself dictate agency action subject to direct appellate review. Nonetheless, ALPA concluded as to the bias claim that district court review "might affect" the court of appeals' jurisdiction.142

Accordingly, as one looks carefully at the factual contexts of cases following *TRAC*, the difficulties of discerning a meaningful limit to the "might affect" language multiply. From the cases, one might infer that *TRAC*'s formula should indeed be seen to include nearly any claim raising a question involving a statute that provides for review of final action in a court of appeals. If that were its proper reading, all a litigant would have to do to oust the district court of jurisdiction would be to invoke such a statute and seek relief in relation to it.[143] This potentially enormous sweep of the "might affect" language prompted one court to complain that the phrase "could mean anything, or, since any final administrative action is subject to plenary review by the Court of Appeals, it could mean nothing."[144]

To summarize this section's discussion, the exact meaning and scope of *TRAC*'s jurisdictional doctrine remain open to contention regarding its three main aspects. At the very least, *TRAC* has not achieved its laudable objective of introducing clarity into a complex area of law.

B. *Policy Implications: The Tenuousness of TRAC's Result*

Despite its doctrinal weaknesses, the most likely result of following *TRAC* remains clear enough: it is to prefer exclusive court of appeals' jurisdiction in preliminary settings. A defender of *TRAC* might assert that even if its doctrine is subject to question, a presumption in favor of such exclusive review remains a good one.

I will respond to that view by arguing that *TRAC*'s penchant for exclusive appellate power is in tension with basic values and institutional understandings underlying jurisdictional inquiry. At bottom, the problem is that *TRAC* reverses the presumption that seems supported by complex purposive analysis, namely, that district courts are the more appropriate fora for resolving the kinds of disputes that are likely to arise in preliminary settings. At a minimum, I will suggest, no clear advantage of court of appeals review justifies a sweeping rule of exclusive appellate power.

This section's analysis will proceed in two steps. First, I will discuss main policy arguments for appellate and district court review, and consider their applicability to the *TRAC* context. Second, having considered *TRAC*'s substantive problems, I will respond to rejoinders likely to be heard from its supporters.

1. Competing Values and *TRAC*

To begin, imagine a case involving a claim of unreasonable agency delay. The agency has not reached any final decision, and thus there is no formalized administrative record encapsulating the reasons for and basis of a decision. In some such cases the agency has given no explanation for the alleged delay. In other cases the agency's explanation will raise doubts of a factual nature that are not resolved on the basis of materials available to the parties. The judicial inquiry -- is the delay arbitrary and capricious or is it reasonable and not subject to judicial relief?[145] -- requires an understanding of the record, the agency's explanation, and pertinent facts. If the case is swept into a court of appeals, *TRAC* indicates that the court could remand to the agency for an explanation or development of the record. Alternatively, and presumably more rarely, the court could appoint a special master to hear arguments about the facts and report to the court. Both of these possibilities presuppose that the court of appeals itself is not set up to engage in a record-oriented inquiry on its own. By tradition, organization, and competence, the courts of appeals are simply not fora designed for airing and testing arguments primarily concerned with the factual underpinnings of an agency's decisionmaking process.

Consider in this context the major policies relevant to forum allocation determinations. For ease of analysis, these might be summarized as policies favoring court of appeals review and policies favoring district court review.

In favor of court of appeals review are the policies against unnecessary delay, duplication, and waste of judicial resources, and the policies favoring the use of appellate expertise and the special capacities of appellate courts to harmonize the law of a circuit.[146] Are these policies served by channelling preliminary challenges such as in *TRAC* exclusively to the courts of appeals?

The arguments about delay, duplication, and waste presuppose that the administrative process has already yielded a product that is similar in kind, if not identical, to the product that would be produced in a trial court. This may well be the case with respect to a final order based on a record encapsulating the evidence, the findings of fact, and the conclusions of law relevant to a particular decision. In such a circumstance, there is strong appeal to the position that there may be no need for another trial-level process. After all, would it not tend to repeat the kind of process already conducted in an agency, thereby delaying review and perhaps wasting limited judicial resources?[147] But this is not the situation of *TRAC*-type delay claims or preliminary claims generally. How can one say there will be duplication and waste of time when the original trial-level process, eventuating in a record and final decision, has not been completed at the administrative level?

The arguments about appellate expertise and the appellate court's ability to harmonize the law of a circuit also seem to miss the mark. Both arguments presuppose that the key role of appellate adjudication is to address difficult questions of law in an effort to resolve disputes about them and thereby to clarify obligations under statutory and other norms. To be sure, there is no hard-and-fast line between "legal," "policy," and "factual" questions, and many administrative law cases involve "mixed" issues.[148] Be that as it may, the special expertise and role of appellate tribunals focus not on the elaboration of facts but on the development of law. The arguments about expertise and intra-circuit consistency do not have their greatest force in contexts where primary and initial doubt revolves around the basic record of, or facts underlying, agency decisionmaking. To that extent, the core of these policies for exclusive appellate review does not apply to preliminary challenges such as in *TRAC*.

One also should recall that earlier commentators -- Currie and Goodman as well as the Administrative Conference in 1975 -- supported a presumption in favor of district court review of informal adjudications, the major residual category of administrative decisionmaking.[149] The idea was that such decisions are not normally based on a developed record, and thus the dangers of duplication between agency and court are minimized. This rationale also applies, it seems to me, to preliminary challenges against allegedly unreasonable delay as to which there is no developed agency record. The idea is not that the agency can give no explanation; the notion is that the plaintiff or court may wish to probe an explanation that is not fully developed or supported.

The conditions stated by the Administrative Conference for overcoming the presumption of district court review of informal adjudications also do not seem to apply.[150] The main questions raised by a preliminary challenge to delay seem unlikely to involve major issues of law or of broad social and economic impact, but rather are likely to be rather context-specific. Moreover, it is difficult to assume in advance that no further development of the grounds of decisionmaking would be needed with respect to a challenge to preliminary, not final, agency behavior that by definition is in some stage of inchoateness.[151]

As one turns to policies favoring initial district court review, one encounters the following main arguments. The district courts should be used to address and resolve questions about an agency's record that may involve factual issues. They have special ability to absorb a burgeoning caseload given that their numbers are so much greater than appellate courts. Their very organization and self-conception allow them to respond more fully to the kinds of arguments likely to be raised in preliminary settings.[152]

The first point, of course, is central to the extent that preliminary challenges such as to alleged delay are likely to raise factual questions about the justification given for delay. It is no secret that district courts are expert in the substantive and procedural law concerning fact development. They are also accustomed to the give-and-take of a motions practice. Precisely because they sit in panels of one, not three, they can respond more quickly to inquiries about a record than an appellate tribunal, even assuming an appellate court would consider the matter directly.[153]

The concern about the respective caseloads of district and appellate tribunals also lends some support to the notion that district courts are more appropriate fora for initial review of preliminary challenges to administrative decisionmaking. Although both levels of the federal judiciary are overloaded, the problem has been seen as particularly serious at the appellate level, where the courts have less flexibility for expansion given that they sit in panels of three.[154] To that extent, *TRAC*'s penchant for exclusive appellate review flies in the face of broader institutional considerations about caseload.

Finally, we come back to the litigant raising a preliminary challenge to agency decisionmaking. What effects will the factors discussed thus far likely have on the litigant's case? At a minimum, it will be difficult to raise primarily factual questions. Any opportunities for discovery within the limits allowed under existing law will plainly be reduced further if a litigant must appear initially in a court of appeals.[155] Also, the speed of decisionmaking in district courts is likely to be greater than in appellate courts, which take understandable pride in their collegial and deliberatiVe processes.[156]

There is particular irony in the fact that *TRAC* seems to have fostered some delay in the resolution of claims of agency delay. The thrust of such claims, of course, is that quicker movement in decisionmaking is required. Whether or not a court agrees with the claim, shifting it from district courts to the courts of appeals seems inevitably to postpone its resolution, given that panels of three judges tend to act more deliberately in their decisional processes.

All of these considerations, taken together, create a serious possibility that the interests of justice will not be served by *TRAC*'s forum preference. To the extent that a litigant seeks to raise the type of questions for which district courts are especially suited, and yet the litigants are forced into the courts of appeals initially, the parties may be blocked in practical effect from raising their challenges. At bottom, the fact that *TRAC* strains against many institutional policies that govern in this area has a very real and dangerous implication: litigation is likely to be skewed, and opportunities to raise claims denied, by virtue of a narrow jurisdictional holding reached on tenuous analysis.

2. Responses to *TRAC*'s Supporters

TRAC's supporters might seek to respond at least in part to these objections by arguing that, on balance, the remand and special master possibilities are good enough to ameliorate any problems resulting from *TRAC*'s penchant for exclusive appellate review.[157] The difficulty with this as an omnibus solution is that remands and masters involve considerable costs of their own. One might imagine initially that eliminating two-tier judicial review would result in greater savings. But the relative lack of fact-finding capacity in the appellate courts and the delays resulting from remands and masters must lead one to question that initial assumption. Why not channel actions to the courts able most efficiently to probe or develop a record, assuming that such is not unlikely to be required? Why use burdensome remand techniques that might force agencies to adopt fact-finding procedures that could conceivably impair the efficiency of the administrative process? And why rely on special masters, who after all can be expected to be seldom employed, given a natural disinclination of courts of appeals to interrupt their review of a case in such fashion?[158]

Moreover, it bears underscoring that *TRAC*'s discussion of remands and special masters is addressed to a concern distinct from the ultimate advisability of such techniques. The discussion arises in the context of an argument against the view that courts of appeals will not be able to provide legally adequate review. This is an important contention because the Administrative Procedure Act states that when "special statutory review proceedings" are inadequate, "a court of competent jurisdiction" is to exercise power over the action.[159] The district court, acting under its general federal question power, would be a "court of competent jurisdiction." Therefore, it is necessary for *TRAC* to determine whether court of appeals review is legally inadequate. *TRAC* notes rightly that courts of appeals can use remands or special masters and that such possibilities help to defeat a claim of alleged inadequacy of review.[160] All of this, however, does not go to the heart of the matter here. It is one thing to say that appellate review is not statutorily inadequate, and quite another to claim that it is not the less appropriate type of review, at least as compared with review by district courts. To put the point affirmatively, to uphold the legal adequacy of court of appeals review is not also to establish its desirability.

Without suggesting that appellate review would be inadequate, then, one can indicate that district court review should be preferred as an initial matter. It is ultimately unsurprising that such preference would have special weight in the context of preliminary challenges, where there may be particular ambiguity about the basis of the agency's decision or lack of decision.

One might anticipate other responses from *TRAC*'s supporters. Some agencies might argue that district courts will be less favorably inclined to the agencies than will courts of appeals, which may be more sympathetic to the problems of administration. Some private litigants might take the view that whichever level of court they are most familiar and comfortable with is the level that should hear their cases. These arguments ring with a high degree of result orientation. They seem largely to cancel out one another. They suffer from a common defect of not dealing in a principled way with the difficult questions of federal jurisdiction.

For instance, it is true that proceeding in district court might open up the possibilities of status conferences and some court-supervised probing of the record. If one takes the position that these are always bad, then one will not be well-attuned to reversing *TRAC*. However, on what conceivable grounds could they always be bad? To assert that is to prejudge in general whether there is ever a need for the kind of supervision of a case that a district judge can muster. Any such assertion by an agency carries with it the taint of unreasonable self-interest.

In addition, to assert the likelihood of a parade of horribles from reversing *TRAC* -- such as massive delay, wasted resources, appeals without limit -- is to ignore that there is no showing these things occurred in the pre-*TRAC* universe. Indeed, just as the competencies of district courts can be useful in preliminary settings, there is no indication they were misused by courts prior to *TRAC*'s ruling.

It might be suggested that litigants themselves are somehow chastened by having to bring preliminary challenges in the courts of appeals, assuming that review of final agency actions would be brought in such courts. The idea is that if a plaintiff can bring a preliminary claim in a district court, it is more likely to be frivolous, poorly grounded, or otherwise less than meritorious than if the plaintiff had to bring the action before the court that would hear a challenge to final action.

This prediction about litigant behavior is difficult to assess. Is it not as likely that a litigant bent on bringing what everyone else would concede to be "frivolous" litigation will do so no matter what forum is available? In any event, it seems unlikely that district judges will be well-disposed to frivolity in their courts. Cannot we trust district judges to deal appropriately with "frivolous" claims? Moreover, it is difficult to imagine how losing a "frivolous" preliminary challenge in a district court can help a litigant on review of a final order.

Even if this suggestion presents an important concern, the category of cases to which it might pertain is least likely to include challenges to unreasonable agency delay, the very context in which *TRAC* was written. This is so because as to an unreasonable delay challenge, the litigant by definition is seeking expedited agency decisionmaking, not the reverse. The potential gains from retarding administrative closure on some issue seem unlikely to be uppermost in the minds of a plaintiff attacking alleged agency foot-dragging.

To summarize, *TRAC*'s result is not only subject to doctrinal critique; also, its penchant for exclusive appellate jurisdiction raises serious questions of policy. This is especially so in the preliminary context at issue in *TRAC*, in which the capacities of district courts are particularly relevant and to which their procedures and institutional positions are notably well-suited.

IV. Alternatives to *TRAC*

In this section, I will consider alternatives to *TRAC*'s jurisdictional approach. The first part will elaborate upon the fundamental critique contained in the earlier sections of this study. The second part will consider what should be done if one is not ready to follow this study's analysis to the conclusion of rejecting *TRAC*.

A. *Fundamental Critique*

For all of the reasons discussed in this study, I believe that *TRAC*'s preference for exclusive appellate review of preliminary challenges is poorly grounded. This does not mean that I support the mirror image of *TRAC*, exclusive district court review. That is also a one-sided approach, insensitive to competing concerns, and more rigid than necessary to meet the needs of jurisdictional inquiry. It also ignores the force for the All Writs Act, which gives jurisdiction to a court of appeals in a *TRAC*-type setting if the court should choose to use it. Instead of exclusive review, I favor the alternative of concurrent power.

The argument for concurrent jurisdiction is as follows. First, it is generally accepted that direct appellate review provisions do not bar district court review as an initial matter in cases to which those provisions do not apply.[161] As noted above, the direct review statute in *TRAC* does not specifically apply to a preliminary challenge to allegedly unreasonable agency delay.[162] Accordingly, general federal question jurisdiction should remain in such a case. Moreover, if one accepts *TRAC*'s All Writs Act analysis, it is possible for a court of appeals to exercise its power to issue a writ in aid of its prospective jurisdiction.[163] In appropriate circumstances, then, each level of court could assert a separate statutory basis for jurisdiction.

One might make two sorts of replies. First, courts often remark that concurrent jurisdiction is disfavored. Second, a scheme of concurrent power might be said to be unworkable.

As to the first point, remarks critical of concurrent power generally appear in cases interpreting a particular direct review statute. In such a case the court must ask whether a specific agency decision is covered by a special review provision. If it is not, it follows that the federal question at issue could go to a district court, even though other claims under the statute might go to the appellate court. That kind of bifurcated jurisdiction may indeed be disfavored, at least when complex purposive analysis supports consolidation of the different challenges in the courts of appeals.[164]

However, such a line of analysis is not directly applicable to *TRAC*. *TRAC*, again, does not just involve the interpretation of a direct review statute. It therefore does not raise a simple problem of potential bifurcation of review under the same law. Rather, *TRAC* grounds appellate power in the All Writs Act, read in conjunction with the FCC's direct review statute. To say that there may be concurrent power in a *TRAC*-type situation -- under the All Writs Act for the appellate court and under 28 U.S.C. §1331 for the district court -- is not to "bifurcate" review. It is rather to recognize two distinct lines of statutory authority providing alternative bases of judicial review. One cannot "bifurcate" what is already completely distinct.

Thus, what creates the possibility of concurrent power in *TRAC*-type situations is the coincidence of separate statutory theories, of which one applies to district courts and another applies to courts of appeals. The real task for analysis is not to read out of existence one or another of the available theories, but to allocate jurisdiction as allowed by law in keeping with general principles of complex purposive inquiry.

As to the second point, a scheme of concurrent power of the courts of appeals and the district courts is not unworkable. First of all, the number of cases in which concurrent power could exist is quite limited. A large body of cases would be governed by established doctrine, long antedating *TRAC*, that when a special review statute channels an action to a court of appeals, that statute cuts off district court review under general grants of federal jurisdiction.[165] Moreover, when agency action is not covered by a special review provision, the normal presumption is that the matter should be heard originally in the district courts.[166] The new situation raised by *TRAC* is the case in which a court does not conclude that a preliminary challenge is covered by a special review provision, and thus there is no immediate consolidation in the courts of appeals, but the court of appeals does consider that the All Writs Act provides power for it to hear the challenge in order to protect its jurisdiction. At the same time, since the special review provision does not apply, the traditional understanding remains that the district court retains general federal question jurisdiction.

Moreover, the arguments herein against *TRAC*'s penchant for exclusive appellate review tend to support a general presumption that, in preliminary settings like *TRAC*'s, the district courts should ordinarily be the forum of original review. This is so for two reasons. First, again, when a special review provision does not apply, the normal understanding always is that power resides in the district courts. In addition, the main policies in this area point toward such review in the usual case of a preliminary challenge. These include policies favoring the elaboration of the record underlying a preliminary action and the relatively greater competence of district courts in such an enterprise. A presumption in favor of original district court review in *TRAC*-type settings would not eliminate the possibility of appellate power being exercised under the All Writs Act. Yet such exercise of power would tend to be exceptional, not normal.

With the proposed alternative to *TRAC*, we have an approach of workable simplicity that nonetheless acknowledges the concurrence of different jurisdictional theories. The proposed approach is not to be confused with proceeding case-by-case without unifying guidance about where a preliminary matter in general should be heard originally.

B. *Partial Critique*

One might remain reluctant to seek *TRAC*'s overruling -- perhaps out of commitment to the principle of stare decisis. For one taking such a viewpoint, does the foregoing discussion have any implications for action falling short of *TRAC*'s reversal?

On the one hand, the thrust of this study is that *TRAC* should be abandoned. On the other hand, particular criticisms along the way can be gathered together to support reforms short of the ultimate solution. I would mention a few points in particular.

First, to the extent that this study has implications for Congress, the key point is that *TRAC*'s problems might have been averted if Congress specifically had addressed the question of jurisdiction over preliminary challenges like delay. To be sure, statutes are likely to be subject to conflicting interpretations. Nevertheless, it would be salutary for Congress, whenever it considers the question of judicial review of final agency action, also to consider carefully where preliminary challenges are to be brought. Are they to go to the courts of appeals, the district courts, or both?

Second, to the extent that this study has implications for courts that either must or choose to follow *TRAC*, certain points seem worthy of note. The least controversial is that when *TRAC* cannot apply because a preliminary challenge has been brought before the nature of an agency's final action has been determined, and therefore it is unclear where the final action will go, *TRAC* should simply be recognized not to apply. Otherwise, *TRAC* would require mere speculation about an agency's intentions.[167]

Also, the practical effects of *TRAC*'s forum preference on the resolution of delay claims, and related claims such as against agency inaction, should be carefully considered. In general, moving such claims -- which, after all, are brought to prevent further postponement of decisionmaking -- from district courts to appellate courts seems likely to extend the time within which they are able to be resolved. This is so given the generally more deliberative character of court of appeals' decisionmaking, including the time to assign to a panel, the time for briefing, any time consumed by oral argument, and the time to prepare a formal opinion. Moreover, panels of three judges do not have the flexibility of a single judge. Would not delay and inaction claims be fit subjects for possible abbreviation of the normal process of appellate review, especially to the extent that such claims tend to be highly fact-specific and often do not involve complex legal issues?

To be sure, the most effective measures may vary depending upon the practices of individual courts. Nevertheless, possible approaches to avoid postponing initial appellate review of delay or inaction claims suggest themselves. Courts might, in appropriate instances, develop rules permitting decisions on briefs without oral argument, the filing of petitioners' briefs simultaneously with notices of appeals, expedited calendering of delay cases, informal status or settlement conferences involving a single judge, or -- where the record may require expansion through factfinding -- prompt assignment to a district court, magistrate, or other official for that purpose.

The foregoing steps would help to address certain discrete difficulties spawned by *TRAC*. Although representative of only a partial critique, they would constitute meaningful if limited reforms in this important area of the law.

Conclusion

This study's conclusion is that *TRAC*'s preference for exclusive appellate jurisdiction over preliminary challenges to administrative behavior is subject to serious doubt, both methodologically and substantively. To underscore the focus of this doubt, it may be useful to highlight *TRAC*'s novelty.

TRAC joins two well-established lines of authority to create its own doctrine. The first line of authority, represented by *Whitney National Bank*,[168] establishes that when a direct review provision applies, it normally will be deemed exclusive and thereby will oust the district courts of general federal question jurisdiction. The second line of authority, represented by Dean Foods,[169] allows an appellate court, when it deems it "necessary or appropriate," to assert power over a preliminary matter under the All Writs Act to protect the court's ultimate jurisdiction.

TRAC combines these two principles in the manner of doctrinal building blocks. *TRAC* concludes that when the All Writs Act provides appellate power over an administrative challenge, and when final agency action (if and when it occurs) would be reviewed exclusively by the courts of appeals, then the All Writs Act-derived power also is exclusive. This reasoning extends the long-settled exclusivity principle concerning direct review statutes to situations where the All Writs Act is the necessary predicate for review, so long as a direct review provision would have applied if there had existed a covered final agency action.

As we have seen, the analysis leading to this result seems flawed. It represents a style of abstract reasoning about the aims of appellate review that fails to deal concretely with a host of countervailing policies that should be addressed when jurisdictional questions arise. The court's invocation of the notion of an "anomaly" said to result from failing to treat preliminary decisionmaking the same as final agency action is indicative of its abstract style of reasoning. Why is it so anomalous to see the two situations as distinct, given that they are in fact so and that well-established policies concerning the competencies of different levels of the federal judiciary support a contrast between inchoate and final agency decisionmaking? More generally, why speak in terms of would-be anomalies at all, as if to suggest that the question in *TRAC* is one of formal reasoning rather than a complex task of applying competing institutional policies to the facts?

Moreover, *TRAC*'s formula for exclusive appellate review -- which is to occur when final agency action would be reviewed under an agency's statutes exclusively by the courts of appeals, and when a suit seeks relief that "might affect" the court of appeals' ultimate review power -- raises formidable difficulties for interpreters. These difficulties congregate around each of the three main elements of *TRAC*'s jurisdictional doctrine.

First, it is often not clear where final actions are to be reviewed, although *TRAC*'s doctrine, read by itself, would seem to assume the contrary.

Second, it is not clear whether a challenge to administrative behavior just needs to be "under" an agency's statutes in a broad sense or whether *TRAC* should be read to apply only to claims based specifically on the agency's organic statutes.

Third, the "might affect" test in *TRAC* is so vague that, when combined with its abstract style of legal reasoning, the test could be seen to sweep within its scope nearly any preliminary challenge to administrative decisionmaking. Such massive displacement of the district courts can be avoided only if a meaningful limit is placed on the scope of *TRAC*'s exclusivity principle. Yet none was established by *TRAC* or has been settled upon in subsequent cases. To the contrary, basic confusion surrounds the concept of what "might affect" the court of appeals' ultimate review power. To the extent that this core idea in *TRAC* remains opaque, the decision's jurisdictional holding is bound to contribute to doubts and frustration on the part of litigants as well as courts.

Finally, *TRAC* raises additional questions when viewed in light of the policies that inform complex jurisdictional reasoning. *TRAC* does not take account of important functional differences between the courts of appeals and the trial courts in the key area of testing or expanding the record underlying a challenged decision. *TRAC* creates the risk that justice will not be served because litigants are less able to raise record-oriented issues given the limits of the forum to which they have been exclusively assigned.

TRAC's impulses to push for greater clarity, predictability, and reduction in time spent on jurisdictional analysis seem laudable. The problem is that these impulses are pursued in a manner that is both at odds with the needs of multi-factored jurisdictional discussion and self-defeating on its own terms. What we need instead of *TRAC* is recognition of the concurrent power of the courts of appeals and the district courts in *TRAC*-type situations. Moreover, we need a presumption in favor of the district court's original review in preliminary settings. Such an approach satisfies the policies that inhabit this field and creates a meaningful degree of clarity. Even short of this recommended approach, discrete steps could be taken to address some of the problems presented by *TRAC*.

In the end, *TRAC* teaches us the pitfalls of holding in too inflexible a fashion to the tendency of channelling administrative actions initially to the courts of appeals. Any trend toward direct appellate review needs to be critically assessed in terms of basic jurisdictional principles and the policies that may be served, or disserved, in different contexts.

Notes for "Jurisdictional Debate in Administrative Law: A Comment on Telecommunications Research and Action Center v. FCC"

1. For discussion, *see* Pierce, The Role of Constitutional and Political Theory in Administrative Law, 64 Tex. L. Rev. 469 (1985).

2. *See, e.g.*, Heckler v. Chaney, 105 S.Ct. 1649 (1985).

3. *See* Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978).

4. *See* Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) (analyzing statutory authority and urging broad deference to agency construction); Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983) (ratifying "hard look" approach to the review of the substance of an agency's decision).

5. *See e.g.*, K. Davis, 4 Administrative Law Treatise §23:5 (1983); L. Jaffe, Judicial Control of Administrative Action 157 (1965); Wright, Miller & Cooper. Federal Practice and Procedure: Jurisdiction 2d § 3568 (22d ed. 1984).

6. For exceptions, *see* Currie and Goodman, Judicial Review of Federal Administrative Action: Quest for the Optimum Forum, 75 Colum. L. Rev. 1 (1975); Note, Jurisdiction to Review Federal Administrative Action: District Court or Court of Appeals, 88 Harv. L. Rev. 980 (1975).

7. 750 F.2d 70 (D.C. Cir. 1984).

8. *See id.* at 75.

9. *See* Insurance Corp. v. Compagnie Des Bauxites, 456 U.S. 694, 701-702 (1982) ("The validity of an order of a federal court depends upon that court having jurisdiction over... the subject matter. Federal courts are courts of limited jurisdiction. Subject matter jurisdiction... is an Art. III as well as a statutory requirement; it functions as a restriction on federal power...."); L. Jaffe, *supra* note 5, at 156; C. Wright, The Law of Federal Courts 103 (4th ed. 1983); Hart, The Power of Congress to Limit the Jurisdiction of Federal Courts, 66 Harv. L. Rev. 1362 (1953).

10. *See* 28 U.S.C. § 1331. A 1976 amendment to the general federal question jurisdiction provision established that no amount in controversy was required in suits "against the United States, any agency thereof, or any officer or employee thereof in his official capacity." Pub. L. No. 94-574, 90 Stat. 2721. "Finally in 1980 Congress acted again and removed completely the requirement of an amount in controversy for suits brought under §1331." Wright, Miller, & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3561.1 at 17 (2d ed. 1984).

11. 15 U.S.C. § 45(c) (authorizing a "petition for review" of FTC actions in the courts of appeals). *See* L. Jaffe, *supra* note 5, at 157.

12. *See* H.R. Rep. No. 1142, 63d Cong. 2d Sess. 19 (1914) (Conference report on the FTC Act of 1914) ("In order to obtain the speediest settlement of disputed questions, it is provided that the commission shall apply for the enforcement of its orders directly to the circuit court of appeals. The findings of the commission as to the facts are to be conclusive. The court's function is restricted to passing on questions of law. The court will determine such questions on the record in the proceeding before the commission.").

13. *See* 28 U.S.C. §§2341-2353.

14. The Administrative Orders Review Act's legislative history confirms that it sought to advance the values of expedition and efficiency in the judicial system. *See* H.R. Rep. No. 2122, 81st Cong. 2d Sess 3-4 (1950) (discussing rationale for substituting review of designated orders by courts of appeals instead of by three-judge district courts: "... the submission of the cases upon the records made before the administrative agencies will avoid the making of two records, one before the agency and one before the court on review, and thus going over the same ground twice. Under the Administrative Procedure Act..., the record before the agencies will be made in such a way that all questions for the determination of the courts on review, and the facts bearing upon them, will be presented and the rights of the parties will be fully protected."); S.Rep. No. 2618, 81st Cong. 2d Sess. 4-5 (1950) ("The pattern used here is the one established for review of orders of the Federal Trade Commission in 1914... and followed by other laws since then... The proposed method of review has important advantages of simplicity and expedition in the disposition of a considerable class of business of the federal courts.").

15. For discussion, *see* Sustein, *Lochner's Legacy*, 87 Colum. L. Rev. 873 (1987); *Constitutionalism After the New Deal*, 101 Harv. L. Rev. 421 (1987).

16. The APA is at 5 U.S.C. §§ 551 *et seq.* & 701 *et seq.*

17. For discussion of procedural review, *see* Shapiro and Levy, Heightened Scrutiny of the Fourth Branch: Separation of Powers and the Requirement of Adequate Reasons for Agency Decision, 1987 Duke L.J. 387, 404-410.

18. Of course, district court review remains in many instances. *See, e.g.*, 42 U.S.C. § 405(g) (calling for district court review of Social Security Act Claims). Professor Davis has stated that the 1980 annual report of the Administrative Office of United States Courts noted 2,950 "Reviews of Administrative Agency Cases" by the courts of appeals. A corresponding total for the district courts was not available, as no such general reporting category has been established. Yet a suggestive comparison may be derived from considering, for instance, the following subtotals of cases decided by district courts: 9,043 social security cases; 23,287 "prisoner petitions" (with no indication of the number involving review of administrative action); 3,271 tax suits; 12,944 civil rights cases; 8,640 cases involving "labor laws"; 3,783 cases involving patents, copyrights or trademarks; and 627 Freedom of Information Act cases. Although it is difficult to make a specific comparison without greater knowledge of the issues in these lawsuits, Professor Davis has estimated that the ratio of administrative actions decided by district courts to those decided by courts of appeals was "five or more times" to 1. K. Davis, *supra* note 5, § 23:3 at 131.

19. *See* Davis, *supra* note 5, § 23:5 at 133-34.

20. *See* 750 F.2d at 75.

21. *See id.* at 74 note 22. A lack of subject matter jurisdiction is an issue that can be raised "at any time during the life of a lawsuit by either party or by the trial or appellate court on its own motion." Wright & Miller, Federal Practice and Procedure: Civil 2d § 1063, at 224 (1987). *See* Louisville & Nashville Railroad v. Mottley, 211 U.S. 149 (1908).

22. Telecommunications Research & Action Center v. FCC, No. 84- 1035 (D.C. Cir. June 12, 1984) (order requesting parties to brief jurisdictional issues in *TRAC*).

23. The FCC argued in an earlier case, ultimately dismissed as moot, that "[t]he Court should rule that it has exclusive authority in appropriate circumstances to issue writs of mandamus at least against agencies such as the FCC under the pertinent special review statutes, the All Writs Act, and the APA." Reply Brief of Federal Communications Commission on Petition for a Writ of Mandamus at 5, *In re*

National Treasury Employees Union, No. 84-5010 (D.C. Cir. 1984). The FCC followed that view in *TRAC*. *See* Brief for Federal Communications Commission at 13-15, TRAC v. FCC, Nos. 84-1035, 84-5077.

24. Petitioner opted to rely upon amicus briefs filed in *In re* National Treasury Employees Union, No. 84-5010 (D.C. Cir. 1984). *See* Petitioners' Brief Supporting Petition for Mandamus and Petition for Review at 2 note, TRAC v. FCC, Nos. 84-1035, 84- 5077.

25. *See* Brief for Intervenor GTE Service Corporation at 7-12, TRAC v. FCC, Nos. 84-1035, 84-5077.

26. *See* Brief for Interventor American Telephone and Telegraph Company at 16, TRAC v. FCC, Nos. 84-1035, 84-5077 ("this Court has jurisdiction . . . although this jurisdiction is not exclusive in the courts of appeals but is also within the authority of the district court in appropriate circumstances").

27. 28 U.S.C. § 1651(a) (1982).

28. 750 F.2d at 76.

29. *See* the dissent in FTC v. Dean Foods Co., 384 U.S. 597, 615 (1966), in which Justice Fortas strongly objected to the majority's approval of the All Writs Act as a basis for jurisdiction in a preliminary context. For discussion of Dean Foods, *see infra* at notes 124-28.

30. *See* the majority in Dean Foods, *supra* note 29; *see also* United States v. United States District Court, 334 U.S. 258 (1948); Roche v. Evaporated Milk Ass'n, 319 U.S. 21 (1943); McClellan v. Carland, 217 U.S. 268 (1910); Potomac Electric Power Co. v. ICC, 702 F.2d 1026 (D.C. Cir. 1983). For general support of the use of the All Writs Act as a predicate for appellate jurisdiction, *see* Wright, Miller, Cooper & Gressman, Federal Practice and Procedure: Jurisdiction § 3942 at 320 ("Avowedly interlocutory intervention under the All Writs Act might be expanded with considerable profit.").

31. This principle has been invoked in a variety of circumstances. *See, e.g.*, Whitney National Bank v. Bank of New Orleans & Trust Co., 379 U.S. 411, 419-23 (1965); Macauley v. Waterman Steamship Corp., 327 U.S. 540, 543-45 (1946); Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 48-50 (1938); Louisville & Nashville Railroad Co. v. Donovan, 713 F.2d 1243, 1245-46 (6th Cir. 1983); Compensation Department of District 5 v. Marshall, 667 F.2d 336, 340 (3d Cir. 1981); Assure Competitive Transportation, Inc. v. United States, 629 F.2d 467, 471 (7th Cir. 1980); Investment Co. Institute v. Board of Governors, Federal Reserve System, 551 F.2d 1270 (D.C. Cir. 1977); Virginia Electric & Power Co. v. Costle, 566 F.2d 446 (4th Cir. 1977); Anaconda Co. v. Ruckelshaus, 482 F.2d 1301 (9th Cir. 1973); UMC Industries, Inc. v. Seaborg, 439 F.2d 953, 955 (9th Cir. 1971); United States v. Southern Railway Co., 380 F.2d 49, 53-54 (5th Cir. 1967). *But see* Sebben v. Brock, 815 F.2d 475 (8th Cir. 1987) (holding that district court retains some residuum of mandamus power, despite an apparently applicable direct review scheme, in narrow circumstances where claimant shows either patent violation of agency authority or manifest infringement of substantial rights irremediable by statutory review and where agency has a clear nondiscretionary duty to act); Louisville & Nashville R. Co. v. Donovan, 713 F.2d. 1243, 1246 (6th Cir. 1983); Nader v. Volpe, 466 F.2d 261 (D.C. Cir. 1972).

32. *See* 750 F.2d at 77 ("By lodging review of agency action in the Courts of Appeals, Congress manifested an intent that the appellate court exercise sole jurisdiction over the class of claims covered by the statutory grant of review power. It would be anomalous to hold that this grant of authority only strips the District Court of general federal question jurisdiction. . . when the Circuit Court has present

jurisdiction under a special review statute, but not when the Circuit Court has immediate jurisdiction under the All Writs Act in aid of its future statutory review power.") and 78 note 36 ("It would be highly anomalous for us to hold that remand to the agency or appointment of a special master cannot cure evidence deficiencies in the record of ongoing agency proceedings when the Supreme Court has said they are quite adequate for review of the same issues after final agency action.").

33. *See* 750 F.2d at 77-78.

34. *See id* at 78.

35. *See* FCC v. ITT World Communications, Inc., 406 U.S. 463 (1984). *TRAC* acknowledged that *ITT* dealt with final agency action and, therefore, was not fully dispositive. 750 F.2d at 78 note 36. Nevertheless, the court found *ITT* persuasive and controlling, stating that "[i]t would be highly anomalous for us to hold that remand to the agency or appointment of a special master cannot cure evidence deficiencies in the record of ongoing agency proceedings when the Supreme Court has said that they are quite adequate for review of the same issues after final agency order." *id.*

36. 750 F.2d at 78-79. This same language, with the addition of underscoring the word "exclusive", appears at *id.* at 75.

37. *See id.* at 75 note 24.

38. *TRAC's* approach was not unprecedented, however, for it paralleled a suggestion made in a concurring opinion in Association of National Advertisers v. FTC, 627 F.2d 1151, 1179 (D.C. Cir 1979) (Leventhal, J., concurring), *cert. denied* 447 U.S. 921 (1980). The plaintiff in that case sought disqualification of the FTC Chairman in a pending rulemaking. The case was brought in district court, which exercised jurisdiction. The court of appeals reaffirmed the district court's power, reasoning that "where the final agency decision may be reviewed does not by itself determine the court in which a plaintiff seeking interlocutory relief may pursue his cause of action." *Id.* at 1158. This reasoning was questioned in a separate opinion by Judge Leventhal, who wrote: "I posit a total lack of jurisdiction in the district court to consider the merits of plaintiff's case in any way or to any extent." *Id.* at 1179. Relying on *Dean Foods*, 384 U.S. 597 (1966), Judge Leventhal suggested that the court of appeals had exclusive power. He acknowledged that his view, which he did not much elaborate, was "novel" and "not argued." *TRAC* in essence resurrected Judge Leventhal's position and made it the law of the D.C. Circuit. *See* 750 F.2d at 76 note 28 and at 77 note 30 (citing with approval Judge Leventhal's concurrence).

39. *See, e.g.*, Association of National Advertisers v. F.T.C., 627 F.2d 1151, 1157 (D.C. Cir. 1979), *cert. denied* 447 U.S. 921 (1980) (holding that district court has jurisdiction over nonfrivolous constitutional claims of agency bias and prejudgment); Public Citizen Health Research Group v. Commissioner, Food and Drug Administration, 740 F.2d 21, 34-35 (D.C. Cir. 1984) (raising no question about District Court's jurisdiction in decision remanding case to trial court for purpose of gathering additional evidence); Public Citizen Health Research Group v. Auchter, 702 F.2d 1150 (D.C. Cir 1983) (not questioning original jurisdiction of district court).

40. *See, e.g.*, Potomac Electric Power Co. v. ICC, 702 F.2d 1026, 1032-33 (D.C. Cir. 1983) (initially brought in court of appeals); MCI Telecommunications Corp. v. FCC, 627 F.2d 322 (D.C. Cir. 1980) (initially brought in court of appeals, jurisdiction not questioned); Association of National Advertisers v. FTC, 627 F.2d 1151, 1179 (D.C. Cir. 1979) (Leventhal, J., concurring) (arguing that jurisdiction to compel agency action lies exclusively in the appellate court that has jurisdiction to review on merits); Action for Children's Television v. FCC, 546 F. Supp. 872, 874-75 (D.D.C. 1982) (holding in favor of court of appeals' jurisdiction).

41. *See* 750 F.2d at 72. The court further said that there were "inconsistencies" among its prior decisions. *Id.* at 75.

42. 28 U.S.C. § 2342(a) provides that the "court of appeals has exclusive jurisdiction to enjoin, set aside, suspend (in whole or in part), or to determine the validity of -- (1) all final orders of the Federal Communications Commission made reviewable by section 402(a) of title 47. . ." Section 402(a) makes reviewable in the courts of appeals "[a]ny proceeding to enjoin, set aside, annul or suspend any order of the Commission under this Act."

43. Of course, any challenge to preliminary agency decisionmaking must be reviewable for *TRAC* to apply. Among other things, agency decisionmaking must have achieved a status of "finality" that would permit a court with jurisdiction to review the matter. *See, e.g.*, Bethesda-Chevy Chase Broadcasters, Inc. v. FCC, 385 F.2d 967, 968 ((D.C. Cir. 1967), *quoting* Chicago & Southern Air Lines v. Waterman Steamship Corp., 333 U.S. 103, 113 (1948) ("to be final an order must 'impose an obligation, deny a right or fix some legal relationship as a consummation of the administrative process'"); CIBA-Geigy Corp. v. U.S. Environmental Protection Agency, 607 F. Supp. 1467, 1469 (D.D.C. 1985) ("An agency's decision is final if (1) it is definitive or there are no further agency procedures, (2) the action has legal force or great practical impact, and (3) judicial review would be efficient or would serve to enforce the regulatory scheme.").

The finality doctrine is related to, yet distinct from, other key notions concerning the timing of judicial review: ripeness and exhaustion. *See* Public Citizen Health Research Group v. FDA, 740 F.2d 21, 30 (D.C. Cir. 1984) ("Ripeness is primarily concerned with ensuring that issues are in a posture fit for *judicial* review. . . Finality is primarily concerned with protecting the integrity of the *administrative* process"). The finality doctrine contrasts with the exhaustion requirement because the former may create an issue even if there are no pending agency procedures as such to exhaust. *See generally* L. Jaffe, *supra* note 5, at 418, *quoting* Isbrandtsen Co. v. United States, 211 F.2d 51, 55 (D.C. Cir.), *cert. denied* 347 U.S. 990 (1954) (finality depends "'upon a realistic appraisal of the consequences of such action'; the test is the irreparable injury threatened in the exceptional case by administrative rulings which attach legal consequences to action taken in advance of other hearings and adjudications that may follow").

44. An interlocutory challenge to alleged agency bias was covered by *TRAC's* jurisdictional principles in that decision's companion case, *Air Line Pilots Association v. Civil Aeronautics Board (ALPA)*, 750 F.2d 81 (D.C. Cir. 1984). In *ALPA* the airline pilots claimed that bias as well as unreasonable delay infected the CAB's process for determining whether certain employees had lost their jobs because of a "qualifying dislocation," which could trigger unemployment assistance under 49 U.S.C. § 1552(a)(1)(h) (i)(1982). The Board has begun receiving applications for such determinations in January 1979, but by October 1983, it had taken no action on them.

After asserting jurisdiction, the district court dismissed for failure to state a claim for which relief may be granted. The court of appeals asked the parties to address the issue of subject matter jurisdiction. On the strength of *TRAC*, the court of appeals reversed on the ground that the case sought relief that could "affect our future statutory power of review over final agency action. . ." 750 F.2d at 84. The court underscored that the bias claim "has equal power to affect our future jurisdiction over final agency action" as does an unreasonable delay claim. *Id.* at 84.

In another case involving a claim of bias, *Public Utility Commissioner of Oregon v. Bonneville Power Administration*, 767 F.2d 662 (9th Cir. 1985), the Ninth

Circuit followed *TRAC* . In that case the Public Utility Commissioner of Oregon and three investor-owned utilities challenged the constitutionality of ongoing proceedings of the Bonneville Power Administration to revise certain rate formulas. The plaintiffs argued that the Administrator had an unalterably closed mind as to the outcome and, accordingly, that the proceeding violated plaintiffs' right to due process. The district court dismissed the action for lack of suhject matter jurisdiction. 583 F. Supp. 752, 753 (D. Ore. 1984). Plaintiffs appealed. On the strength of *TRAC*, the Ninth Circuit affirmed the dismissal below. The court of appeals noted that the relevant statute assigned to it exclusive jurisdiction over final actions by the Administrator. *See* 767 F.2d 622, 625- 26 (9th Cir. 1985). It then applied *TRAC* in concluding that there is exclusive appellate jurisdiction over this preliminary challenge to the constitutionality of agency proceedings. *See id.* at 626-27.

45. In *Community Nutrition Institute v. Novitch*, 583 F. Supp. 294 (D.D.C. 1984), *aff'd sub. nom.* Community Nutrition Institute v. Young, 773 F.2d 1356 (D.C. Cir. 1985), the plaintiff sought an order of the district court requiring the Food and Drug Administration to hold a public hearing concerning the use of the food additive aspartame (commonly known as NutraSweet or Equal). The district court denied plaintiff's motions to stay the approval of aspartame. Thereafter, the FDA rejected plaintiff's request for a hearing. At that point, the district court granted defendant's motion to dismiss on the ground that the final agency ruling on the application for a hearing was reviewable exclusively by the court of appeals. On appeal, the question was whether the district court correctly held that it lacked jurisdiction as soon as the agency had ruled on plaintiff's request for a hearing. The D. C. Circuit agreed that the final agency ruling was exclusively reviewable by an appellate court.

The court of appeals also concluded that the district court had erred in asserting jurisdiction over the case before the agency had entered the final order. It reasoned that under *TRAC*, the district court never had jurisdiction over the case. *See* 773 F.2d at 1361. The plaintiff's challenge to ongoing agency process was considered a plain example of a situation that "might affect" ultimate appellate review. As in other instances, the court of appeals did not discuss in detail the analytical links in this change of argument. Yet the court concluded that under *TRAC*, "[t]he jurisdiction to review agency inaction lies exclusively in this court." *Id.*

46. In *Independent Bankers Association of America v. Conover*, 603 F.2d 948 (D.D.C. 1985), a bankers' association challenged the Comptroller of the Currency's preliminary approval of charters for certain proposed national banks. Plaintiff argued that the Federal Reserve Board, rather than the Comptroller, was the agency authorized to review the proposed charters under relevant banking statutes. The bankers asked the district court, *inter alia*, to refer the matter to the Federal Reserve Board for its advice on the applicability of its statutory authority.

The district court ruled that it had no power to issue directions to the Board since that entity's orders were subject to direct review by the court of appeals. The court cited *TRAC* for the proposition that where a statute commits agency action to review by the court of appeals, "any suit that might affect that future jurisdiction" is exclusively reviewable in such court. *Id.* at 956. The district court reasoned that if it were to direct the Board to take action, it would be affecting the court of appeals' future jurisdiction because it would in effect be requiring a final order by the Board. Such an order is to be reviewed exclusively by the appellate court. Therefore, the district court denied the motion for an order of referral. *See id.* at 956-57.

47. In *International Union, UAW v. Donovan*, 590 F. Supp. 747 (D.D.C. 1984), *aff'd* 756 F.2d 162 (D.C. Cir. 1985), certain labor organizations challenged as arbitrary and capricious the Occupational Safety and Health Administration's failure

to regulate exposure to formaldehyde in the workplace. The district court declined to direct the agency to regulate. Yet it did require the agency to reconsider its refusal either to issue an emergency temporary standard or to institute permanent rulemaking proceedings. Also, the court ordered OSHA to develop a timetable for completing its reconsideration.

After the district court acted, *TRAC* was decided. In reaction to *TRAC*, the district court transferred the case to the court of appeals. The appellate tribunal accepted jurisdiction, albeit without much discussion. It noted that "where a statute commits final agency action to review by the court of appeals, the appellate court has exclusive jurisdiction to hear suits seeking relief that might affect its future statutory power of review." *Id.* at 163. Standards issued by OSHA are exclusively reviewable by the court of appeals. For a district court to order either a temporary emergency standard or permanent rulemaking, the court of appeals reasoned, would mean that the district court would in effect be requiring action that would precipitate direct appellate review. Such action triggering direct review was held to affect the court of appeals' jurisdiction, and thus to be covered by *TRAC*.

48. *See, e.g.*, Sierra Club v. Thomas, 828 F.2d 783 (D.C. Cir. 1987) (Plaintiff challenged EPA's delay in completing rulemaking; court of appeals held, *inter alia*, that district court did not have jurisdiction, in significant part relying on *TRAC*); Oil, Chemical and Atomic Workers International v. Zegeer, 768 F.2d 1480, 1483 (D.C. Cir. 1985) (confirming on basis of *TRAC* that court of appeals has exclusive power over claim by labor organization and health group about allegedly unreasonable agency delay in regulation of miners' exposure to products of radon decomposition); Suburban O'Hare Comm'n v. Dole, 603 F. Supp. 1013, 1031 (N.D. Ill. 1985) (plaintiffs challenged final adjudicatory decision by the FAA approving Chicago's master plan for construction and operation of commercial air carrier facilities; the district court held that there was exclusive appellate power over this matter, citing *TRAC* for the proposition that the relative inability of the court of appeals to take evidence does not, without more, divest that court of statutory jurisdiction); Zantop International Airlines, Inc. v. Engen, 601 F. Supp. 667, 699 (D.D.C. 1985) (plaintiff sought relief with respect to allegedly improper amendment, modification, or suspension of operating certificate under Federal Aviation Act; the district court held that the court of appeals had exclusive jurisdiction under *TRAC* since any relief granted might affect the court of appeals' future jurisdiction); *In re* Global International Airways Corp., 48 B.R. 849, 852 (W.D. Mo. 1985) (plaintiff in bankruptcy case challenged the application to it of certain noise regulations; in concluding that the court of appeals had exclusive jurisdiction, the district court relied significantly on *TRAC* for its discussion of the respective powers of appellate and district courts). *See also* Moss v. Arnold, 654 F. Supp. 19, 22 (S.D. Ohio 1986).

Courts have also relied on *TRAC* in other situations. *See, e.g., In re* GTE Service Corporation, 762 F.2d 1024, 1027 (D.C. Cir. 1985) (plaintiffs challenged FCC decision in a refund proceeding; court of appeals held that pleading could not be entertained as a motion for stay because it was not accompanied by petition to review the underlying order, and that the pleading, regarded as petition for a writ of mandamus, should be denied because of available remedy pursuant to the Communications Act; *TRAC* was discussed by way of contrast with this case, as in *TRAC* a petition for writ of mandamus pursuant to the All Writs Act was deemed appropriate); State of New York v. Thomas, 613 F. Supp. 1472, 1477-78 (D.D.C. 1985) (plaintiffs brought action to require EPA to notify states to revise state implementation plans to abate damage to Canada allegedly traceable to emissions from the Midwest; the court, in the course of granting plaintiff's motion for summary judgment, contrasted this case with *TRAC* in concluding that here, the statutes did not confer exclusive power on the court of appeals and therefore *TRAC* was inapplicable); Ciba-Geigy Corp. v. U.S. EPA, 607 F. Supp. 1467, 1469 (D.D.C.1985) (plaintiff sought relief against future enforcement action by EPA regarding labeling of products containing a certain pesticide; in holding that there was no final agency action to review, the court cited *TRAC* for proposition that where a statute commits review of agency action to the court of appeals, any suit seeking relief that might affect the circuit court's future jurisdiction is subject to the exclusive review of the court of appeals; the court was unable to determine the appropriate application of this principle in the absence of final agency action, and it dismissed the complaint). *See also* United Technologies Corp. v. EPA, 821 F.2d 714, 721 (D.C. Cir. 1987); Cutler v. Hayes, 818 F.2d 879, 887 note 61 (D.C. Cir. 1987); local 1928, American Federation of Government Employees v. Federal Labor Relations Authority, 630 F. Supp. 947, 950 (D.D.C. 1986); *In re* Amtol Corp., 57 B.R. 724, 727 (N.D. Ohio 1986); United Transportation Union v. Norfolk and Western Railway Co., 627 F. Supp. 1008, 1015 (D.D.C. 1985).

49. There are many instances in which courts rely on the language of jurisdictional provisions in reaching their results. *See,* e,g., Ohio Citizens for Responsible Energy, Inc. v. NEC, 803 F.2d 258 (6th Cir. 1986) ("final order" means granting or denying NRC license, not order denying motion to reopen hearing); Citizens for a Safe Environment v. Atomic Energy Commission, 489 F.2d 1018 (3d Cir. 1983) (narrowly interpreting reach of "final order" in jurisdictional statute). *Cf.* New England Telephone and Telegraph Co. v. Public Utilities Comm'n of Maine, 742 F.2d 1 (Ist Cir. 1984).

50. *See e.g.*, Florida Power & Light Co. v. Lorion, 105 S.Ct. 1598 (1985); PPG Industries, Inc. v. Harrison, 446 U.S. 578(1980); Whitney National Bank v. Bank of New Orleans & Trust Co., 379 U.S. 411 (1965); Foti v. Immigration and Naturalization Service, 375 U.S. 217 (1963). Purposive analysis of special review statutes has been praised by commentators. *See, e.g.* L. Jaffe, *supra* note 5, at 159 ("In the absence of a conscious legislative choice, a court should ordinarily he able to skirt the shallows of literalism. . . .").

51. *See* K. Davis, *supra* note 5, at § 23:5 at 134 ("[t]he complexity of the present law stems almost entirely from judicial departures from statutes, even when statutes on their face are reasonably clear").

52. *Compare* 5 U.S.C. § 551(4) (defining rule as "the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency. . .") *with* 5 U.S.C. § 551(6) (defining order as "the whole or part of a final disposition. . .of an agency in a matter other than rule making but including licensing").

53. *See* United Gas Pipe Line Co. v. Federal Power Commission, 181 F.2d 796, 798-99 (D.C. Cir.), *cert. denied* 340 U.S. 827 (1950). *See also* PBW Stock Exchange v. SEC, 485 F.2d 718 (3d Cir. 1973), *cert. denied* 416 U.S. 969 (1974); H. Friendly, Federal Jurisdiction: A General View 176-77 (1973).

54. *See* investment Company Institute v. Board of Governors of Federal Reserve System, 551 F.2d 1278, 1276 (D.C. Cir. 1977) ("[T]he general approach taken by *United Gas Pipe Line* is no longer good law in the circuit"); Deutsche Lufthansa Aktiengesellschaft v. CAB, 479 F.2d 912, 915-16 (D.C. Cir. 1973); City of Chicago v. FPC, 458 F.2d 731 (D.C. Cir. 1971), *cert. denied* 405 U.S. 1074 (1972).

55. *See* 5 U.S.C. § 553; Deutsche Lufthansa Aktiengesellschaft v. CAB, 479 F.2d at 916 ("It is the availability of a record for review and not the holding of a quasi-judicial hearing whicn is now the jurisdictional touchstone"); City of Rochester v. Bond, 603 F.2d 927, 933 note 26 (D.C. Cir. 1979); Investment Co. Institute v.

Board of Governors of Federal Reserve System, 551 F.2d 1270, 1278 (D.C. Cir. 1977); City of Chicago, Illinois v. FPC, 458 F.2d 731, 740-41 (D.C. Cir. 1971). *See generally* Florida Power & Light Co. v. Lorion, 105 S. Ct. 1598, 1607 (1985).

56. *See* Florida Power & Light Co. v. Lorion, 105 S. Ct. 1598, 1608 (1985); FTC v. ITT World Communications, Inc., 406 U.S. 463, 469 (1984); Harrison v. PPG Industries, 446 U.S. 578, 593-94 (1980).

57. *See* Wright, Miller, Cooper & Gressman, Federal Practice and Procedure: Jurisdiction § 3940 at 302 (1977).

58. *See id.*

59. *See id.* at 302-03.

60. *See id.* at 303.

61. For discussion of the problems of congestion and delay in the courts, *see* H. Zeisel, H. Kalven & B. Buchholz, Delay in the Court (2d ed. 1959, reissued 1978). For consideration of the particular problems facing appellate courts, *see* Wright, Miller & Cooper, *supra* note 2, § 3506 at 24 ("The last two decades have seen a precipitous increase in the workload of the courts of appeals. It was said in 1973 that those courts were 'in a state of crisis' (*quoting* H. Friendly, Federal Jurisdiction: A General View 31 (1973)), and the situation has worsened since.") "District-court filings rose 64% between 1960 and 1972, courts-of-appeals filing a whopping 273% . . ." D. Currie, Federal Courts 831 (3d ed. 1982). *See also* Commission on Revision of the Federal Court Appellate System, Structure and Internal Procedures: Recommendations for Change, 67 F.R.D. 195 (1975); Carrington, Meador & Rosenberg, Justice on Appeal (1976); Lumbard, Current Problems of the Federal Courts of Appeals, 54 Cornell L. Rev. 29 (1968); Symposium, Federal Appellate Justice in an Era of Growing Demand, 59 Cornell L. Rev. 571 (1974).

62. The relative importance of the issues raised in a certain case is a significant factor in the jurisdictional analysis proposed in 1976 by the Administrative Conference of the United States. *See* text at notes 85-89 *infra.*

63. *See* text at note 149-56 *infra.*

64. *See* 750 F.2d at 77-79.

65. *See* Whitney National Bank v. Bank of New Orleans & Trust Co., 379 U.S. 411, 422 (1965); Compensation Department of District Five, United Mine Workers v. Marshall, 667 F.2d 336, 340 (3d Cir. 1981); Assure Competitive Transportation, Inc. v. Dnited States, 629 F.2d 467, 471 (7th Cir. 1980), *cert. denied* 449 U.S. 1124 (1981); City of Rochester v. Bond, 603 F.2d 927, 935 (D.C. Cir. 1979); Virginia Electric & Power Co. v. Costle, 566 F.2d 446 (4th Cir. 1977); Investment Co. Institute v. Board of Governors of the Federal Reserve System, 551 F.2d 1270, 1278-79 (D.C. Cir. 1977); Anaconda Co. v. Ruckelshaus, 482 F.2d 1301 (10th Cir 1973); UMC Industries, Inc. v. Seaborg, 439 F.2d 953, 955 (9th Cir. 1971).

66. 379 U.S. 411 (1965).

67. *See id.* at 420 ("The Congress. . .provided for review in the courts of appeal based on the facts found by the Board supported by substantive evidence. We think congressional actions point clearly to the conclusion that it intended that challenges to Board approval of the organisation and operation of a new bank by a bank holding company be pursued solely as provided in the statute.").

68. *See id.* at 422.

69. *See* cases cited at note 65 *supra.* "[A]n impressive line of authority supports the. . .proposition that, even where Congress has not expressly conferred jurisdiction, a special review statute vesting jurisdiction in a particular court cuts off

other courts' original jurisdiction in all cases covered by the special statute." Investment Co. Institute v. Board of Governors of Federal Reserve System, 551 F.2d 1270, 1279-80 (D.C. Cir. 1977).

70. *See* 750 F.2d at 78 ("[T]here are compelling policy reasons for holding that the jurisdiction of the Court of Appeals is exclusive. Appellate courts develop an expertise concerning the agencies assigned them for review. Exclusive jurisdiction promotes judicial economy and fairness to the litigants by taking advantage of that expertise. In addition, exclusive jurisdiction eliminates duplicative and potentially conflicting review,... and the delay and expense incidental thereto."). *Cf.* Whitney National Bank v. Bank of New Orleans and Trust Company, 379 U.S. 411, 422 (1965).

71. *See* 750 F.2d at 75 notes 25 and 26.

72. *TRAC*'s "anomaly" language is quoted in full in note 32 *supra*.

73. The Supreme Court has admonished that statutes creating special review procedures should be "construed both with precision and with fidelity to the terms by which Congress has expressed its wishes." Cheng Fan Kwok v. INS, 392 U.S. 206, 212 (1968). *See also* Commodity Futures Trading Commission v. Nahas, F.2d 487, 492 note 9 (D.C. Cir. 1984) (federal courts must "scrupulously observe the precise jurisdictional limits prescribed by Congress"). To be sure, scrupulous interpretation is not inconsistent with a multi-factored purposive analysis of direct review provisions. *See* L. Jaffe, *supra* note 5, 158-59; Note, *supra* note 6, 984-85 (arguing that careful purposive interpretation of direct review provisions is appropriate when statutory distinction not grounded in discernible legislative policy).

74. *See* PBW Stock Exchange, Inc. v. Securities and Exchange Commission, 485 F.2d 718, 733 (3d Cir. 1973) (review is "better resolved by a forum whose function is fact-finding, a function which the court of appeals in the first instance is singularly ill-equipped to perform"); Indiana & Michigan Elec. v. United States EPA, 733 F.2d 489, 491 (7th Cir. 1984); Public Citizen Health Research Group v. Commissioner, Food and Drug Administration, 740 F.2d 21, 34-35 (D.C. Cir. 1984).

75. *See generally* 750 F.2d at 78.

76. Professors Currie and Goodman have observed that "apart from the qualifications he brings to the bench, the appellate judge is better equipped by his judicial experience as a whole for the task of reviewing administrative action. [A] circuit judge has greater opportunity than a district judge to familiarize himself with the substantive law" of administrative areas. Currie & Goodman, *supra* note 6, at 13. *See also* Wright, Miller, Cooper & Gressman, *supra* note 57, § 3940 at 303. *But see* Florida Power & Light Co. v. Lorion, 105 S. Ct. 1598, 1610 (1985) (Stevens, J., dissenting) (suggesting as "debatable at best" assumption that court of appeals is more expert review forum).

77. For discussion of the strengths of the district court in matters of discovery and conducting trial-type proceedings, *see* Susquehanna Valley Alliance v. Three Mile Island, 619 F.2d 231, 241 (3d Cir. 1980) (in declining to adopt an All Writs Act argument in favor of court of appeals' power over NEPA challenge, concludes that "[w]hile the court of appeals can devise procedures for the preparation of a record. . .the district court has both procedures and facilities at hand for that task"); PPG Industries, Inc. v. Harrison, 587 F.2d 237, 245 (5th Cir.), *rev'd* 446 U.S. 578 (1979) (discussing superior discovery procedures available in district court); PPW Stock Exchange, Inc. v. SEC, 485 F.2d 718 (3rd Cir. 1973); Texas v. Environmental Protection Agency, 499 F.2d 289, 321-22 (5th Cir. 1974).

78. *See generally* Currie & Goodman, *supra* note 6.

79. The Administrative Conference recommendation based on Currie and Goodman's report is discussed *infra* text at 84-89.

80. *See id.* at 49-52.

81. *See id.* at 49 ("[T]he absence of a trial-type record may not present as substantial an obstacle to direct court of appeals review as might appear at first blush. Often the sole issues will involve pure statutory construction.")

82. *See id.* at 57 ("The absence of a formal adjudicatory record justifies, we think, a presumption in favor of district court review. Without such a record, a judicial trial will very often be necessary to determine either the basis upon which the administrator acted or the facts relevant to an evaluation of his action. Furthermore, even where the issues raised are strictly legal, a district court opinion may, in the absence of a formal opinion at the administrative level, be useful to the circuit court in organizing the case for appellate review.").

83. *See generally id.* at 60.

84. The Choice of Forum for Judicial Review of Administrative Action, Recommendation No. 75-3, 1 C.F.R. § 305.75-3.

85. *See id.* at Recommendation 1.

86. *Id.*

87. *See id.* at Recommendation 2.

88. *Id.* at Recommendation 5(b).

89. *Id.* at Recommendation 6(b). The Conference suggested that "[i]nformal orders issued by agencies that mainly engage in formal adjudication and the formal orders which are now subject by statute to direct review by the courts of appeals will normally satisfy these conditions and should therefore be reviewable by the courts of appeals." *Id.* at Recommendation 6(b)(iii).

90. *See* sources cited *supra* note 65.

91. *See* discussion *supra* text at notes 27-30.

92. *See* 750 F.2d at 77-78. *TRAC* notes that the district court lacks jurisdiction under the All Writs Act and the mandamus statute. That does not, however, establish lack of jurisdiction under the general federal question jurisdiction statute. *See id.* at 77.

93. *See, e.g.*, Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984) (turning to principles of deference to agency construction of statutes only after looking to language).

94. *See* cases collected in Davis, *supra* note 5.

95. *See e.g.*, American Industrial Health Council v. Marshall, 494 F. Supp. 941 (D. Tex. 1980) (Secretary's generic cancer policy was an occupational safety and health standard under 29 U.S.C. §§ 652(8) and 655; jurisdiction to review such policy lay in court of appeals rather than in the district courts). Standards are made reviewable in the courts of appeals by 29 U.S.C. § 655(f). For the distinction between "standard" and "regulation," *see, e.g.*, Louisiana Chemical Assn. v. Bingham, 657 F.2d 777, 779-85 (5th Cir. 1981).

96. *See* 21 U.S.C. § 355.

97. *See* 21 U.S.C. § 355 (h).

98. Again, when a special review provision does not apply, district court jurisdiction remains. 21 U.S.C. § 355(h) applies to an agency order "refusing or withdrawing approval of an application."

99. 625 F. Supp. 747 (D.D.C. 1986), *aff'd* 814 F.2d 731 (D.C. Cir. 1987).

100. *See* Humphrey's Executor v. United States, 295 U.S. 602 (1935).

101. *See* 625 F. Supp. at 748. ("Plaintiffs subsequently brought this action, seeking a declaration that the delegation of law enforcement powers to the FTC is unconstitutional because the Commissioners are given the exclusive power to initiate enforcement proceedings, and are not subject to the President's supervisory control.").

102. *See id.* at 749.

103. *See id.*

104. *Id.* at 750.

105. *Id.*

106. 644 F. Supp. 597 (D.Mass. 1986).

107. *See id.* at 598.

108. *See* Air Line Pilots Association v. Civil Aeronautics Board, 750 F.2d 81 (D.C. Cir. 1984).

109. *See* 644 F. Supp. at 600 ("Plaintiff's claim that the reparation program violates Article III of the Constitution stands on a different footing, however. . . Although consideration of the merits of First Commodity's claim may have some effect on future appellate jurisdiction, I agree. . .that the holding of *TRAC* is limited to claims seeking review of agency process, and does not encompass constitutional challenges to (an) agency's enabling statute.").

110. 628 F. Supp. 1548 ((D.D.C. 1986).

111. *See id.* at 1551 note 2.

112. *Id.* at 1551.

113. *See id.*

114. Ticor Title Insurance Co. v. Federal Trade Commission, 814 F.2d 731, 744 (D.C. Cir. 1987) ("I would also vacate that portion of the District Court's opinion and holding pertaining to jurisdiction under 28 U.S.C. Section 1331 (1982)"). *See generally* Flynt v. Weinberger, 762 F.2d 134 (D.C. Cir. 1985).

115. 814 F.2d at 743 ("Because I would hold that the appellants' constitutional claim not be raised in federal court until the appellants have exhausted their administrative remedies, I need not reach an issue considered at some length by the District Court; namely, whether the District Court would have had jurisdiction under the general federal question statute, 28 U.S.C. 5 1331 (1982), to entertain a constitutional challenge to the exercise of law enforcement powers by the FTC.").

116. *See id.*

117. *Id.*

118. *See id.* at 743-44.

119. Ticor Title Insurance Co. v. Federal Trade Commission, 814 F.2d 731, 757-58 (D.C. Cir. 1987) (Green, J., concurring) ("I subscribe to the view set forth by the District Court in this case, that *TRAC* is inapplicable to cases involving challenges to the constitutionality of an agency's enabling statute.").

120. *See* 750 F.2d at 75, 78-79.

121. 750 F.2d at 76.

122. 750 F.2d at 76 (*quoting* McClellan v. Carland, 217 U.S. 268, 280 (1910)).

123. *Id.* at 76.

124. 384 U.S. 597 (1966).

125. *See* 356 F.2d 481, 481 (7th Cir. 1966).

126. *See* 384 U.S. 597, 603 (1966) ("The All Writs Act... empowers the federal courts to 'issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.' The exercise of this power 'is in the nature of appellate jurisdiction' where directed to an inferior court. . .and extends to the potential jurisdiction of the appellate court where an appeal is not then pending but may be later projected.").

127. *See id.* at 603.

128. *See id.* at 605. Justice Fortas in dissent argued that the majority's view "burdens the court of appeals with a fact-finding duty which they are unable to perform. . ." *Id.* at 615. Justice Fortas questioned the majority's use of the All Writs Act, stating that it had been "abused." In his view, Congress had limited appellate jurisdiction to situations where an order had been entered, and of course one had not been in *Dean Foods*. *See id.* at 622. These arguments, if accepted, would undercut *TRAC*'s jurisdictional analysis at its core. Yet *Dean Foods* remains the law.

129. *See* 750 F.2d at 76.

130. *See id.*

131. *See* 28 U.S.C. § 1331; K. Davis, *supra* note 5, § 23:3 at 129 ("[T]he appropriate district court always has jurisdiction to review any reviewable action of a federal agency unless a specific statute is interpreted to withdraw the jurisdiction conferred on the district court by § 1331.") (emphasis deleted).

132. The standard of review under the Administrative Procedure Act for issues of fact involving on-the-record adjudication or rulemaking is the "substantial evidence" standard. *See* 5 U.S.C. 706(2)(E); Universal Camera Corp. v. NLRB, 340 U.S. 474 (1951). The standard of review of findings of fact made by a district court is a "clearly erroneous" standard. *See, e.g.*, L. Jaffe, *supra* note 5, at 615; Federal Rule of Civil Procedure 52(a) ("Findings of fact shall not be set aside unless clearly erroneous...."). The actual difference in these formulae, as applied, may be doubted. *See* L. Jaffe, *supra* note 5, at 615 ("I know, however, that there are conscientious judges who find difficulty in deriving for themselves the distinction between 'clearly erroneous' and the present 'substantial evidence' rule").

133. As Professor Jaffe put the point: "If there be a distinction between review of a trial court and an agency, it may rest on the special experience of the agency, which may help out an otherwise faltering finding. In reviewing a trial court, an appellate court operates with roughly the same tools and so need not and should not discount its apprehension of clear error." L. Jaffe, *supra* note 5, at 615-16.

134. 603 F. Supp. 948 (D.D.C. 1985) (discussed in note 46 *supra*)

135. *See id.* at 956-57.

136. 590 F. Supp. 747 (D.D.C. 1984), *aff'd*, 756 F.2d 162 (D.C. Cir. 1985) (discussed in note 47 *supra*).

137. 756 F.2d at 163.

138. 583 F. Supp. 294 (D.D.C. 1984), *aff'd sub. nom.* Community Nutrition Institute v. Young, 773 F.2d 1356 (D.C. Cir. 1985) (discussed in note 45 *supra*).

139. Community Nutrition Institute v. Young, 773 F.2d at 1361.

140. 750 F.2d 81 (D.C. Cir. 1984) (discussed in note 44 *supra*). *See also* Public Utility Commissioner of Oregon v. Bonneville Power Administration, 767 F.2d 662 (9th Cir. 1985).

141. *Id.* at 84.

142. *See id.* at 84-85.

143. One might argue that *TRAC* applies if a party simply raises any argument that in some way implicates a statute providing for direct review of final action. However, *TRAC* refers to "any suit seeking relief that might affect" the court of appeals' ultimate jurisdiction. 750 F.2d at 78. The touchstone seems to be that relief by a district court might alter the position of the appellate court. For a decision holding that the district court is not ousted of jurisdiction under *TRAC* when issues arise about the applicability of a statute under which review would be exclusively in the courts of appeals, so long as no agency procedure under that statute has yet occurred, *see* The City of Kansas City, Mo. v. U.S. Dept. of Housing and Urban Development, No. 86-3513, Mem. Op. at 3-4 note 4 (D.D.C., filed August 6, 1987) (Sporkin, J.) (in deciding whether one of two statutes applies, "I am not reviewing any agency action under a statutory provision providing exclusive judicial review in the Court of Appeals (Section 111 [of the Housing and Community Development Act, 42 U.S.C §5301 *et seq.*]), since all of the parties agree that no Section 111 procedure has taken place").

144. Zantop International Airlines, Inc. v. Engen, 601 F. Supp. 667, 669 (D.D.C. 1985).

145. Courts ask whether delay is so unreasonable as to be arbitrary and capricious. The arbitrary and capricious standard also is used in other contexts, including the review of issues of fact arising in an informal agency process. *See, e.g.*, FCC v. National Citizens Committee for Broadcasting, 436 U.S. 775, 803 (1978); Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971); Motor Vehicle Mfrs. Ass'n v. EPA, 768 F.2d 385, 389 n. 6 (D.C. Cir. 1985).

146. For discussion of the importance of the policies favoring appellate review, and the need to ask carefully whether they apply with force in a particular situation, *see* Florida Power and Light Co. v. Lorion, 105 S. Ct. 1598, 1607 (1985). *Lorion* involved a challenge to a final NRC decision denying a petition to institute agency proceedings. The issue was whether the NRC decision was covered by a statute giving the courts of appeals direct review power over final orders granting, suspending, revoking, or amending any license. The argument was made that since there had been no "proceeding" (the issue was whether to institute proceedings), there could be no order in a proceeding as described in the statute, and hence the court of appeals had no power. The Supreme Court viewed the statutory language as indefinite on this point, and concluded that the purposes of appellate review pointed toward such review. The Court stressed the standard litany of reasons for avoiding a formalistic rendering of the terms of a direct review provision -- particularly including the avoidance of duplication and bifurcation of review. The Court noted that the NRC decision rested on a 547-page record, which the Court thought was adequate for the exercise of direct appellate review. It should bestressed that the Court was interpreting the reach of a direct review provision itself, and was not constructing an argument for appellate power based on the All Writs Act. Given all of these factors, Lorion is distinguishable from *TRAC*.

147. *See* Currie & Goodman, *supra* note 6, at 5-6.

148. For one of many possible examples of the difficulties of distinguishing "legal" from "factual" issues in administrative cases, *see* United States v. Fifty-Three Eclectus Parrots, 685 F.2d 1131 (9th Cir 1982).

149. *See supra* text at notes 82, 83, & 89.

150. *See supra* at note 89 (these conditions include the following: the actions typically involve "issues of law or of broad social or economic impact"; they do not usually require "an evidentiary trial at the judicial level to determine either the underlying facts or the grounds on which the agency based its actions"; and they are

either few in number or, if numerous, "would in most cases be likely to reach the appellate courts eventually" by appeal from district court judgments).

151. Granted, this is a somewhat broader rendering of the Conference's reference to an "evidentiary trial," but the underlying idea -- would the district court be useful to fulfill record-enhancement functions? -- remains central. Of the three conditions mentioned for overcoming the district-court preference, only the third seems to obtain: there are rather few cases specifically involving *TRAC*-type circumstances. *See supra* note 150.

152. *See* Susquehanna Valley Alliance v. Three Mile Island, 619 F.2d 231, 241 (3d Cir. 1980) (suggesting district court is better situated efficiently to prepare record) and other sources cited in note 78 *supra*. *See also* Currie & Goodman, *supra* note 6, at 7-10.

153. *See* Currie and Goodman, *supra* note 6, at 7-10; H. Friendly, *supra* note 53, at 29-31, 40-46.

154. *See* sources cited in note 61 *supra*.

155. To be sure, judicial review of administrative decisions is normally conducted on the agency record submitted to the court for review. *See, e.g.*, Florida Power & Light Co. v. Lorion, 105 S.Ct. 1598, 1607 (1985); Camp v. Pitts, 411 U.S. 138, 142-43 (1973); Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971). But this presupposes there is a record to review. In a delay context, for instance, there may be no developed record.

In such a preliminary setting, the question could arise whether the litigant challenging agency behavior will be able to achieve some discovery. In authorizing discovery in *Overton Park*, *supra*, the Supreme Court departed from the rule of United States v. Morgan, 313 U.S. 409 (1941), which stated in broad language that one should not "probe the mental processes" of administrative decisionmaking. To the extent that there is a tension between *Overton Park* and *Morgan*, it has been explained on the basis that in *Morgan* there was an administrative record and a formal agency decision, whereas in *Overton Park* there was no such record and formal process and the relevant facts had to be generated in order for review to proceed. *See* National Nutritional Foods Assn. v. FDA, 491 F.2d 1141 (2d Cir 1974); S. Breyer & S. Stewart, Administrative Law and Regulatory Policy 624 (2d ed. 1985). This rationale generally would seem to apply to cases raising *TRAC* issues: preliminary challenges prior to the development of a complete record and final decision. *Cf.* National Courier Ass'n v. Board of Governors of Federal Reserve System, 516 F.2d 1299, 1242 (D.C. Cir. 1975) ("Unless he has left no other record of the reasons for his decision, the mental processes of an administrator may not be probed.").

156. *See* sources cited in note 153 *supra*.

157. *See* 750 F.2d at 78.

158. It may appear, at first blush, that elimination of two-tier review would result in significant savings. *See* Harrison v. PPG Industries, Inc., 446 U.S. 578, 593-94 (1980) ("The most obvious advantage of direct review by a court of appeals is the time saved compared to review by a district court, followed by a second review on appeal."). *See generally* Currie & Goodman, *supra* note 6, at 48-50. Yet the relative lack of fact-finding capacity in the appellate court (and the possible use of remands or special masters) forces one to question the actual savings involved as compared with initial district court review. *See* Currie & Goodman, *supra* note 6, at 11 ("Sending these issues back to the agency or to a master can cause delay...."), 60 ("If frequently employed, however, the remand technique could force agencies to adopt burdensome factfinding procedures that Congress did not see fit to impose and

that could seriously impair the efficiency of the administrative process."). For discussion of costs associated with special masters, *see* Brazil, Special Masters in Complex Cases: Extending the Judiciary or Reshaping Adjudication?, 53 U. Chi. L. Rev. 394, 417-423 (1986). *See also* Panel Discussion on the Expanding Role of U.S. Magistrates and Masters, 47 Antitrust L.J. 1254 (1979).

159. *See* 5 U.S.C. §703 (1982).

160. *See* 750 F.2d at 78 ("We find untenable any suggestion that appellate review of nonfinal agency action may be inadequate due to Courts of Appeals' inability to take evidence. This precise argument was recently rejected by the Supreme Court in *ITT*, where the Court held that, if an agency record is insufficient, the Court of Appeals may either remand the record to the agency for further development or appoint a special master under 28 U.S.C. 5 2347(b)(3)."). *See also* FCC v. ITT World Communications, Inc., 406 U.S. 463 (1984).

161. *See* sources cited in note 65.

162. *See supra* text at note 27.

163. The fact that a case might more appropriately be handled by a district court does not, by itself, rob an appellate court of any jurisdiction acquired under a statute. *See* K. Davis, *supra* note 5, § 23:3 at 136 ("the need for taking evidence never defeats whatever jurisdiction it (the court of appeals) may have, because 28 U.S.C. § 2347 has ample provisions for referring a case either to the agency or to a district court for the taking of evidence").

164. *See, e.g.*, Foti v. Immigration and Naturalisation Service, 375 U.S. 217, 232 (1963) (considering bifurcation of judicial review under §106(a) of the Immigration and Nationality Act between appellate district courts to be "inconvenient" and "undesirable); Matter of Certain Complaints under Investigation, 783 F.2d 1488, 1497 (llth Cir. 1986) ("[we] are disinclined to find concurrent jurisdiction absent express congressional authorisation"); City of Rochester v. Bond, 603 F.2d 927, 939 (D.C. Cir. 1979) ("The policy behind having a special review procedure in the first place...disfavors bifurcating jurisdiction over various substantive grounds between district courts and the court of appeals"); Sun Enterprises, Ltd. v. Train, 532 F.2d 280, 287 (2d Cir. 1976) (in discussing applicability of direct review provision, court noted that "there is a strong presumption against the availability of simultaneous review in both the district court and the court of appeals"); Oljato Chapter of Navajo Tribes v. Train, 551 F.2d 654, 660-661 (D.C. Cir. 1975) ("bifurcated jurisdiction between the District Court and Court of Appeals over identical litigation is not favored").

165. *See* sources cited in note 65 *supra*.

166. *See* 28 U.S.C. §1331.

167. *See* discussion *supra* text at notes 95-98.

168. Whitney National Bank v. Bank of New Orleans and Trust Co., 379 U.S. 411 (1965).

169. Federal Trade Commission v. Dean Foods Co., 384 U.S. 597 (1966).

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-7

FEDERAL AGENCY
VALUATIONS OF HUMAN LIFE

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I. Introduction

Regulation of health and safety hazards provides protection at a price. Using regulation to decrease the number or severity of accidents, injuries, and illnesses typically requires the expenditure of societal resources. Notwithstanding the benefits that can be conferred by these expenditures, the limited nature of available resources means that their dedication to this purpose requires forgoing alternative uses. Thus, decisions to take advantage of an opportunity for risk reduction necessarily confronts the issue: is the reduction worth the cost? Put in the extreme, this question asks what we as a society are willing to invest in order to save lives, or -- more crudely -- what price we place on human life. As harsh or cold-blooded as this inquiry might seem, it is both a common and necessary part of government regulation of hazards.

The inevitability of this issue does not suggest, however, that all regulators will define the "value of life" equally or even similarly. Indeed, there is substantial evidence that federal agencies differ widely on life valuation questions that determine the propriety of a particular regulation. Some agencies employ explicit valuations of life in determining the relative benefits of a proposed regulation, while other agencies eschew any such calculation. Even the latter, of course, reveal an implicit value that can be inferred by computing the cost of a regulation and the number of lives that would be saved through its adoption. Our discussions with agency officials suggest that where explicit figures are used there recently has been convergence around a figure of $1-2 million per statistical life. For instance, economists at the Consumer Product Safety Commission utilize that range.[1] Nevertheless, agencies have used substantially varying numbers in calculating the benefits of particular regulations. EPA staff have employed figures between $400,000 and $7 million.[2] The Nuclear Regulatory Commission has adopted a somewhat different approach; it evaluates the "value-impact" of proposed regulations by assigning a monetary value of $1000 per person-rem that would be averted by a given proposal.[3] By one calculation, NRC's figure translates into $7.4 million per fatality averted.[4]

Agencies that do not adopt explicit values of life may still predict both the cost of implementing a proposed regulation and the number of lives that would thereby be saved. The implicit cost of regulation per life saved derived from these figures permits some inference about the value of life assumed in agency action or inaction. For example, the Office of Management and Budget[5] has documented values per life saved in discrete rulemakings ranging as low as $70,000 (in a 1980 Consumer Product Safety Commission regulation of space heaters) and as high as $132,000,000 (in a 1979 regulation of the Food and Drug Administration banning DES in cattle feed). Were decisions to regulate based on a strict comparison of costs and benefits, adoption of the CPSC regulation would imply that the agency valued life at a figure *no less* than $70,000 while rejection of the FDA regulation would imply a valuation of *no greater* than $131,999,999. In another investigation of rulemakings concerning environmental carcinogens at four agencies -- Environmental Protection Agency, Consumer Product Safety Commission, Occupational Safety and Health Administration, and Food and Drug Administration -- researchers found that, at least in this important class of health regulation, we as a society tend to regulate vigorously if lives can be protected at less than $2 million per life saved, but not if costs are significantly higher.[6]

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[1] See, e.g., Memorandum from Paul Rubin to L.J. Sharman, May 27, 1987.

[2] Conversation of authors with Ralph A. Luken, Chief, Economic Studies Branch, Environmental Protection Agency.

[3] See 10 C.F.R. §50, Appendix I; Division of Risk Analysis, Office of Nuclear Regulatory Research, Nuclear Regulatory Commission, A Handbook for Value-Impact Assessment 3.15 (1983).

[4] Spangler, Trans-Scientific Issues in Risk-Cost-Benefit Analysis of Energy Options 13 (unpublished manuscript 1985). An earlier NRC report translated the person-rem standard into a wider range of $4 million to $100 million depending on assumptions made. See NUREG - CR2899, Analysis of a Proposed $1000 Per Man Rem Cost Effectiveness Criterion (1982).

[5] See Office of Management and Budget, Regulatory Program of the United States Government, 1987-1988 xx (hereinafter "OMB").

Standing alone, variation in implicit or explicit values is not necessarily troublesome. As we discuss later in this report, different circumstances may justify the use of different valuations of lives. More problematic, however, is a divergence among agencies in the effort expended to derive a meaningful calculus of factors to be used in determining whether regulatory costs are justified, given the resulting savings of lives. Although some agencies -- notably EPA[7] and the Federal Highway Administration[8] -- have commissioned extensive studies that seek to draw on and expand existing knowledge about life valuation, our research reveals less intense documentation efforts at the vast majority of agencies. Some agencies appear willing to accept a figure, notwithstanding the absence of independent evaluation of its veracity or its application to the borrowing agency's regulatory task.[9]

Given the range of figures and methodologies employed in the valuation of human life, there is justifiable concern that selections are based on the regulator's predisposition about a proposal's desirability rather than on the merits. Certainly valuations can be set purposefully as one of several criteria guiding decision makers. For instance, Viscusi, in surveying available normative studies of life valuation, found that (depending on the particular circumstances) plausible justifications are available for values from $600,000 (where individuals place themselves voluntarily in high risk situations) to $7 million (where risks are involuntary and remote).[10] Recent reviews of valuation studies support a range of $1.6 to $8.5 million.[11] But, of course, value of life outcomes also may be a by-product of decision making that is guided by other considerations entirely. Indeed, as we shall see, some argue that such numbers are largely devoid of meaning and, in any event, repugnant or irrelevant.

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[6] Travis et al., Cancer Risk Management: A Review of 132 Federal Regulatory Decisions, 21 Environmental Science and Technology (1987).

[7] See EPA, Valuing Reductions in Risks: A Review of the Empirical Estimates -- Summary (1983).

[8] See Federal Highway Administration, Alternative Approaches to Accident Cost Concepts -- State of the Art (1984).

[9] In hearings concerning EPA's asbestos regulations, Jack Campbell, Deputy Assistant Administrator for Policy, Planning, and Evaluation at EPA, stated: "The $1 million per life saved figure is in essence an arbitrary figure in any (regulatory) analysis, and it is used basically as a baseline to judge whether there are positive or negative net benefits to society as a result of a particular action." EPA's Asbestos Regulations, Hearings Before the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, 99th Cong., 1st Sess., April 16, 1985, at 455.

[10] See Viscusi, The Valuation of Risks to Life and Health: Guidelines for Policy Analysis 201-02 n.5, in J. Bentkover et al., Benefits Assessment: The State of the Art (1986).

[11] Fisher, Chestnut, & Violette, The Value of Reducing Risks of Death: A Note on New Evidence (forthcoming).

Why life saving values differ across types of rulemakings and agencies, whether they should vary, and the propriety of the manner in which agencies derive and utilize them comprise the focus of this report. We begin in Section II with a discussion of the Executive Orders and statutory and case law that define the parameters for agency valuation practices. Section III then turns to a broad array of issues that arise in the valuation process, including philosophical reservations about any explicit valuation efforts and more pragmatic questions concerning valuation techniques. Finally, Section IV provides our concluding observations and recommendations for improvements in agency practice.

One final caveat is necessary before we proceed to the substance of this study. Our inquiry is to determine how human life is and ought to be valued on those occasions when federal agencies determine such calculations to be desirable. We are not here concerned with defining the circumstances under which consideration of the value of human life should be an integral part of agency decision making. As we indicate in the next section, that determination requires analysis of applicable case law, statutes, and executive orders. Our recommendations speak only to those situations in which an agency has determined, based on one of these independent mandates, that the value of human life is a necessary or useful variable in a policy decision. Additionally, we are not here concerned with the propriety of particular modes of analysis in which the value of human life may be a factor. Specifically, we do not seek to re-enter the continuing debate over the use of a strict cost-benefit analysis with respect health and safety regulation. We seek instead to recognize that under several modes of analysis it may be helpful to assign some value to human life. For instance, even if one rejects the proposition that environmental decision making should be predicated exclusively on a comparison of monetized costs and benefits, attention to monetized values may be useful to determine whether conclusions reached on the basis of other variables deviate significantly or only minutely from conclusions that would be reached through a cost-benefit calculation. Nevertheless, we recognize that, for some, any discussion of monetized values for human life conjures images of mechanistic or amoral decision making. Thus, we wish to indicate strongly at the outset that our attention to the question of valuation does not necessarily entail endorsement of any particular procedure for ultimate determinations of the desirability of regulation. We do believe that valuation of life provides data that can be considered in any such determination. It is for the political process to ascertain the variables ultimately considered in any decision concerning regulation. The credibility of any such conclusion, however, depends on the reliability and availability of the underlying information. For that reason, it is essential that the methods used for valuation of human life be as complete and open as possible. It is with that end in view that we proceed.

II. Legal Bases for Agency Valuation of Human Lives.

Administrative agencies that possess statutory authority to promulgate health and safety regulations face a variety of constraints on what and how they may regulate. The most obvious and direct of these are contained in certain generic laws such as the Administrative Procedure Act[12] and in each agency's organic statute. While the generic laws are silent on life valuation matters, a number of specific statutes limit and guide agencies in ways that affect any attempt to value human life, as discussed in Section II.B. We also examine in that section an additional array of life valuation constraints appearing in judicial decisions. First, however, we review in Section II.A the tier of requirements that has emanated from the executive branch and been superimposed on the more traditional statutory and judicial constraints.

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[12] 5 U.S.C. §§ 551-59, 701-06, 3105, 3344, 5362, 7521.

A. Overview of Executive Orders Mandating Cost/Benefit Analysis and Associated OMB Guidance

Most statutes allow agencies considerable discretion in the design and implementation of new regulations. Such agency discretion is substantially narrower where the Congress specifically designates the regulatory action to be taken by an agency, but congressional intervention in the minutiae of implementation is uncommon. In the main, Congress provides fully detailed mandates only where it lacks confidence in prior (as with NHTSA's auto ignition/seat belt interlock regulation) or expected (as with deadlines imposed to accelerate some EPA regulation) agency conduct. Even then, however, agencies are left with responsibility for a host of practical decisions that usually prove necessary to translate a statutory design into an implemented regulation. Thus, managing the regulatory process requires much agency judgment, often extending to basic decision criteria and priorities in addition to the unavoidable details of implementation.

When Congress delegates to an administrative agency the duty to regulate a health or safety problem, it typically is expressing its intent that the agency's specialized expertise guide regulatory action.[13] The Congress, that is, looks to the head of the designated agency, and not to the President, for the solution to a problem. This creates a natural tension, or at least an added decision complexity, for those agencies that are subject to White House supervision (i.e., those agencies whose heads serve at the pleasure of the President). For inherent in the executive function of the Presidency is the obligation to ensure the faithful execution of the law, which unavoidably entails responsibility for agency exercise of discretion.[14]

Recent administrations have taken progressively increased cognizance of this authority and have used it to structure regulation in a manner consistent with broad political objectives. A White House managerial process has evolved to guide agency use of whatever discretion exists in the regulatory statutes. The Reagan Administration in particular has made vigorous use of the Executive order mechanism and of the 1980 Paperwork Reduction Act in managing the issuance of regulations. It has articulated a distinctive set of regulatory principles and established a more potent central oversight process than existed previously.

The current process grew out of several years of experimentation with shifting White House review mechanisms.[15] The most noteworthy antecedent prior to 1974 was the "Quality of Life Review" process started in 1971 by the Office of Management and

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[13] See DeMuth & Ginsburg, White House Review of Agency Rulemaking, 99 Harv. L. Rev. 1075, 1077-79 (1986) (arguing that deference to agencies furthers the objective of efficient rulemaking).

[14] See, e.g., Sierra Club v. Costle, 657 F.2d 298, 405-07 (D.C. Cir. 1981).

[15] The following discussion of the 1975-81 period is drawn from Hopkins, Social Policy and the Regulatory Process: A 1986 Working Paper of the Project on the Federal Social Role. See also, Baram, Cost-Benefit Analysis: An Inadequate Basis for Health, Safety, and Environmental Regulatory Decisionmaking, 8 Ecol. L. Q. 473, 502-15 (1980); OMB, supra note 5.

Budget.[16] Motivated principally by concern about rising budgetary and industrial compliance costs of new environmental regulations, OMB Director George Shultz signed memoranda directing agencies to submit significant regulatory proposals to OMB for review. In practice, this review process focused on proposals from only one agency, the Environmental Protection Agency. The process involved interagency meetings, convened by OMB, at which EPA defended its intended actions in a hostile forum dominated by staff from OMB and the Department of Commerce. This mechanism had narrow scope and dubious authority, but it continued to operate until 1977, when EPA declared that it would no longer participate.

Starting well before 1977, however, the Quality of Life Review process came to be superseded gradually by oversight mechanisms with stronger legal footholds. In 1974, President Ford signed the first of what has turned out to be a very significant series of Executive Orders on the regulatory process. As it came to be implemented, his 1974 Executive Order 11821 required that those agencies whose heads serve at the pleasure of the President prepare an Inflation Impact Statement ("IIS") for every new regulation likely to have a substantial economic effect. Although the Office of Management and Budget approved several different criteria for agencies to use in deciding which regulations would have large enough effects to warrant an IIS, the standard most heavily relied on involved aggregate compliance costs imposed on those regulated in excess of $100 million in any single year.

The IIS was to include a full appraisal of the benefits and costs of the rule relative to those of promising alternatives, but the agency did not have to base its decisions about design or issuance of the rule on the IIS, or even use it in the decision process. An inadequate (or non-existent) IIS posed no direct legal problems, and afforded private parties no new grounds for litigation. The courts saw it as an internal managerial tool clearly within the discretion of the President to apply as he saw fit.[17]

Essentially the IIS analysis provided contending interests added targets or support and served as a key resource for White House overseers. During its seven-year existence (1974-81), the Council on Wage and Price Stability ("CWPS"), which served as the principal regulatory monitoring unit within the Executive Office, used the IIS to shift the regulatory debate toward efficiency concerns. (The initial labels did not suggest this emphasis; indeed, both the IIS and the creation of the CWPS had reflected renewed worry about inflation.) With no powers to coerce, the CWPS' influence derived from its access to agency decision makers and its broad statutory authority[18] to issue public statements on pending rulemaking proceedings.

The efficiency perspective advocated by CWPS gradually came to be accepted as legitimate and potentially powerful. During the Ford Administration, CWPS prepared and publicized policy papers sharply critical of many regulatory proposals. This stimulated greater public debate and increasingly put regulators on the defensive. In response, some regulators began to take the IIS requirements much more seriously, seeking to explain more explicitly the economic effects of their proposals. Near the end of the Ford Administration, Executive Order 11949 changed the IIS label to Economic Impact Statement to reflect its true focus.

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[16] See Eads & Fix, Relief or Reform? 46-50 (1980); National Academy of Public Administration, Presidential Management of Rulemaking in Regulatory Agencies 9 (1987).

[17] See, e.g., Meat Packers Assn. v. Butz, 526 F.2d 228, 234-36 (8th Cir. 1975), cert. denied 424 U.S. 966 (1976).

[18] See P.L. 93-387, §3(a)(7).

The incoming Carter Administration, after more than a year of debate about the CWPS program, decided to continue the CWPS with basically the same role on regulatory matters, and to create a new player, the Regulatory Analysis Review Group ("RARG"). Chaired by the Council of Economic Advisers, the RARG provided a forum for executive branch agencies to discuss the economic analysis of 10 to 20 key regulatory proposals each year. While many agencies were RARG members, it was dominated by staff drawn from units of the Executive Office of the President who were skeptical of traditional regulation.

A new Executive Order (12044) was issued in 1978, replacing President Ford's Executive Order 11949. The analysis required for major new regulations under this order was renamed Regulatory Analysis ("RA") and slightly recast. Each RA was to contain

> a succinct statement of the problem; a description of the major alternative ways of dealing with the problem that were considered by the agency; an analysis of the economic consequences of each of these alternatives and a detailed explanation of the reasons for choosing one alternative over the others.[19]

The Executive Order also added a number of features to regulatory oversight, including a semiannual agenda alerting the public to all nontrivial rules under development. and tighter management of the major rule analysis process. RA's were to be issued in draft form at the rule proposal stage and in final form when the rule was promulgated.

Noteworthy by its absence from the Carter Executive Order was any reference to "benefit cost analysis," which Administration officials thought many perceived as unbalanced and anti-regulatory, in that the less readily quantifiable social benefits would be slighted by cost-benefit analysts. Yet the distinction between that mode of analysis and the "analysis of the economic consequences of . . . alternatives" required for an RA is largely one of semantics and emotions.

The Ford Executive Order had called for cost-benefit analysis to be performed but was silent on how if at all that analysis would be used in actual decisionmaking. The Carter Executive Order moved toward requiring some use of analysis in making decisions, however cautiously: each agency was to select, in any manner it wished, alternative actions it found acceptable; it then was directed to adopt the least burdensome of these alternatives.

Under the leadership of CEA and, to some extent, OMB, the Carter program featured extensive consultation among agencies intended to reach consensus on the analysis and shaping of key regulatory proposals. However, OMB drew narrow limits around its role in this process: "...for OMB to approve or provide appellate review of the substance of individual regulations would be inappropriate and counter to the emphasis on agency accountability in the Executive Order."[20] The consultations held under RARG auspices produced, for each of the small number of regulatory proposals reviewed, a public report that, as a consensus document, was perhaps less strident than many CWPS reports of the Ford period. But in any event such reports continued to be merely advisory.

Within weeks of President Reagan's inauguration, Executive Order 12291[21] made cost-benefit analysis a key determinant of agency decisions, and assigned pre-clearance responsibilities to OMB -- in both cases, to the extent permitted by law. Major regulations continued to face an economic analysis requirement, now renamed Regulatory Impact Analysis (RIA). OMB assumed expanded oversight duties that had previously been shared by CWPS and RARG, both of which were eliminated in 1981.

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[19] Executive Order 12044, §3(b)(1).

[20] 43 Fed. Reg. 126691.

[21] Reprinted in 5 U.S.C. §601 (Supp. 1988).

The Reagan regulatory principles declare that, to the extent permissible under law, regulation should satisfy two primary criteria. First, regulation would be utilized only where it would resolve a problem more effectively than would market forces. Second, regulation was to be structured to maximize net benefits to society. This position, articulated initially in Executive Order 12291, has been amplified in subsequent White House documents,[22] including most notably in the Regulatory Program of the United States Government, April 1, 1987-March 31, 1988. On the theory that one can only determine whether net benefits are maximized through the use of cost-benefit analysis, the Reagan regulatory principles constitute an endorsement of that particular analytical tool.[23]

This Presidential requirement for the use of cost-benefit analysis in regulatory decisionmaking, except where precluded by statute, necessarily carries with it an understanding that those lives at stake in regulatory outcomes will be evaluated in some fashion. Otherwise, any calculation of a regulation's net benefits will exclude what often is its most fundamental objective -- lessening the risk of fatalities. An estimate of the net benefits of a health or safety regulation that takes into account factors such as property damage averted, medical costs avoided, and compliance burden imposed certainly will be misleading and incomplete unless it also includes some valuation of fatalities prevented or of life-years extended.

The Executive Order and related documentation recognize that not all effects of a regulation can be translated into a dollar metric, but they do establish a presumption that much can be accomplished in presenting more comprehensive dollar measurements of both benefits and costs. The concept of net social benefits found in the Reagan regulatory principles is a broad one. It includes any consequence of a regulation that alters the level of material affluence or welfare. Some such consequences are difficult or impossible to measure unambiguously -- e.g., the climate for innovation -- while others can be measured by physical attributes that are difficult at best to convert into dollar terms -- e.g., miles of cleaner waterways. The message conveyed by the Reagan principles is that agencies should attempt to go further than they did previously in quantifying all such effects, whether benefits or costs, and in expressing these effects in dollar terms. The contention is that such explicitness will facilitate arriving at optimal policy decisions.

Once an agency has pushed quantification and monetization of regulatory effects as far as is practicable, the Reagan principles require presentation of its conclusions about net benefits in a way that will not slight those effects that cannot be monetized. There of course always is a temptation for the reader of a partly quantitative and partly narrative analysis to be overly swayed by the former. Nonetheless, the current Administration's principles do not on their face condone disregard of qualitative effects.

As to human life, two obvious questions arise in connection with current regulatory principles. When a regulatory initiative is being contemplated to lessen a health or safety hazard, with what confidence can the agency estimate the number and time pattern of fatalities avoided or deferred? And what, if any, monetary value can be placed on this reduction in fatality risk? The former question is left entirely to the regulatory agency to address; the White House merely encourages the agency to go as far as it prudently can in making such estimates. The latter also is largely -- but not entirely -- delegated to the individual agencies.

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[22] See, e.g., Executive Order 12498, reprinted in 5 U.S.C. §601 (Supp. 1988).

[23] See, DeMuth & Ginsburg, supra note 13.

As the chief player in the Presidential regulatory oversight process, OMB does not endorse any particular number as a suitable statistical value of life for agency cost-benefit analyses. And other White House participants, most notably the Vice President in his capacity as chair of the Presidential Task Force on Regulatory Relief, have distanced themselves from placing any numerical value on human life. There are large political problems -- to say nothing of the philosophical and economic issues -- associated with appearing to assert that a human life can be reduced to a particular dollar value. Explanations that the value is established for analytical purposes and is for a statistical life (or for a measurable though small reduction in the risk of fatality) are insufficiently saleable to avert political damage.

Nonetheless, OMB has an important influence on how agencies do value life in their Regulatory Impact Analyses (the formal analysis that the Executive Order requires for every major regulatory initiative). That influence derives in part from generic guidance offered agencies by OMB on a hortatory basis and in part from the OMB regulatory clearance process. As to generic guidance, the opening sections of the Regulatory Program issued by the White House in the spring of 1987 contain considerable discussion of what OMB views to be the soundest methodology for selecting statistical values of life, as well as evaluative commentary on the range of life values implicit in several agencies' regulatory decisions. That preferred methodology, discussed more fully in Section III.B of this report, is usually termed willingness-to-pay, and is based typically on labor market studies of wage variation across jobs that present differing levels of risk. While this procedure has not led OMB to endorse a particular value for human life, our interviews with staff of that agency indicate they they would generally accept regulations that cost out to less than $2 million per life, but would look askance at regulations that required expenditures much in excess of that figure.

The regulatory clearance process is also an important avenue through which OMB influences agency valuation decisions. Under the 1981 Executive Order, virtually every regulatory proposal (from any agency subject to Executive Order jurisdiction) must be reviewed by OMB at two (or more) junctures before it takes effect. Moreover, Executive Order 12498, issued in 1985, provides that, for all important contemplated regulations, agencies are to consult with OMB prior to beginning work on their design, and out of that consultative process emerges an annual publication of Administration-endorsed regulations under development.

Before an agency publishes a covered regulation in proposed form to obtain public comment (even those too minor to warrant inclusion in the Regulatory Program), it must secure OMB review. At this point, OMB is in a position to object to any aspect of the draft proposal, including whatever value of life the agency may be utilizing in its analysis supporting the proposal. On occasion, disagreement over this value reportedly has been sharp and has led to delay. Under certain circumstances, OMB can block an agency from proceeding until it satisfies OMB that the proposal is consistent with the President's regulatory principles. Finally, before an agency can publish any regulation in final form, it must again go to OMB for a further review round. Thus OMB has ample opportunity -- both on and off the record -- to communicate its views to the regulatory agency on the suitability of any particular value of life.

Not all health and safety regulation encounters this manner of OMB review, because not all regulatory agencies are obliged to conform to Executive Order requirements. Traditionally, the "independent" agencies, whose heads are not subject to Presidential removal, have regarded themselves as exempt from the kind of OMB review discussed above. OMB has a negligible influence on such agencies' practices in valuing life, although some have adopted analytical approaches quite consistent with the basic Executive Order (e.g., the Nuclear Regulatory Commission's internal requirements for economic analysis correspond quite closely with that established by OMB).

Nonetheless, there is one important respect in which OMB does influence regulation at independent agencies. Under the Paperwork Reduction Act of 1980, no agency (independent or otherwise) can enforce a new regulation containing paperwork requirements (information collection elements) until it has obtained OMB concurrence. It is possible but not likely that issues touching on life valuation have important bearing on this OMB/agency interaction, which turns mainly on questions of the reasonableness of the time necessary to supply the information mandated.

B. Constraints of Statutory and Case Law

The executive branch's endorsement of cost-benefit analysis has not achieved universal acceptance within the legislative and judicial branches. Nevertheless, these branches must often wrestle with the issue of whether a particular regulatory effort is appropriate or authorized. Even if these inquiries are not answered by reference to a strict cost-benefit analysis, some consideration of the relevant adverse and positive effects of the proposed regulation would appear necessary for a rational decision. For instance, assume that we must choose between two methods of implementing a program (e.g., a program of vaccination against an anticipated epidemic), each of which would save the same number of lives, but each of which would also produce some new level of risk. The first would present a low level risk (e.g., short term, non-fatal disease due to vaccination) to numerous persons. The second would produce a high level risk (death) to a very small number of persons (e.g., those with severe abreactions) and produce no adverse reactions for anyone else. Can it be said to be illogical or unethical to consider expected losses of each policy in trying to determine which one is superior? Any such process, however, at least implicitly places a value on the lives saved or expended in the decision whether or how to regulate.

The need for agencies generally to balance the positive and negative effects of a proposed regulation -- and hence to evaluate the worth of human life -- is apparent from an examination of the statutes that authorize agency intervention. Most of these statutes confer on administrators some discretion in determining whether to promulgate a particular regulation, but constrain that discretion by reference to regulatory effects on human welfare. These constraints, however, typically are not expressed in terms of an explicit cost-benefit analysis.

In rare cases congressional standards for regulatory action are sufficiently specific that an agency need only determine whether the congressional judgment has been satisfied. Thus, a statute that requires specific agency action when a calculable threshold is passed does not confer on the agency any discretion to determine whether that particular standard is reasonable, necessary, or useful. The agency need strike no balance in which human life would be a necessary factor. Similarly, if congressional judgment required regulation as long as any threat to human life existed, computation of human life values would be unnecessary. Any threat to life would be considered too substantial, so the monetized value of benefits preserved through regulation would be irrelevant. The most celebrated instance of such a provision may be found in the Delaney Clause of the Federal Food, Drug, and Cosmetic Act.[24] The Clause prohibits the use as a food additive, animal drug, or color additive of any substance found to induce cancer in humans or animals.[25] No threshold finding is required; when it comes to cancer, the specified additives and drugs are expected to produce zero risk.

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[24] 21 U.S.C. §§301 - 92.

Alternatively, statutes may go so far as to require explicitly that costs and benefits of proposed agency action be compared before any regulation proceeds.[26] These provisions indicate congressional realization that achieving zero risk is infeasible; at some point the costs of further risk reduction will not be worth the attendant benefits. Thus, regulation depends on some comparison of the two. Since much regulation returns substantial benefits to human welfare in the form of lessened mortality and morbidity rates, a meaningful determination of relative costs and benefits requires that some value be assigned to these welfare effects so that they properly can be incorporated into the calculus.

More frequently, however, congressionally granted authority confers on agencies substantial discretion in the decision to regulate. This discretion may be bounded by standards such as "reasonableness" that permit, but do not expressly require the agency to engage in some sort of comparison of costs and benefits of a proposed regulation in determining its effects on human welfare. For instance, the Federal Insecticide, Fungicide, & Rodenticide Act (FIFRA)[27] permits the Administrator of the Environmental Protection Agency to take protective action with respect to a pesticide that causes "unreasonable adverse effects" on the environment.[28] Similarly, the Atomic Energy Act[29] requires the Nuclear Regulatory Commission to ensure that production of nuclear material will provide "adequate protection" to the health and safety of the public;[30] and the Federal Highway Administration is empowered to publish "reasonable rules" for the safe operation of motor carriers, e.g., driver qualifications, maximum hours, and equipment standards.[31] The Motor Vehicle Safety Act[32] requires that motor vehicle safety standards be "practicable,"[33] a term that the Department of Transportation suggests requires consideration of both technological and economic soundness.[34]

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[25] 21 U.S.C. §§348(c)(3)(a), 360b(d)(1)(H), 37b(b)(5)(B). Richard Merrill suggests that the Delaney Clause is less inclusive or absolute than the debate surrounding its propriety would suggest. See Merrill, Risk-Benefit Decisionmaking by the Food and Drug Administration, 45 Geo. Wash. L. Rev. 994, 998 (1977). On the difficulty of administering such a specific standard, see Merrill, FDA's Implementation of the Delaney Clause: Repudiation of Congressional Choice or Reasoned Adaptation to Scientific Progress?, 5 Yale J. Reg. 1 (1988).

[26] See, e.g., Consumer Product Safety Act § 9(f), 15 U.S.C. §2058(f); Federal Hazardous Substances Labeling Act §3, 15 U.S.C. § 1262(i). The Clean Air Act, 42 U.S.C. §§7401- 7642, requires a benefit-cost analysis for any regulation intended to control the effectiveness of motor vehicle fuel emission control systems. See 42 U.S.C. §7545(c)(2)(B).

[27] 7 U.S.C. §§136 - 136y.

[28] 7 U.S.C. §136d(b).

[29] 42 U.S.C. §§2011-2296.

[30] 42 U.S.C. §2232(a). This provision has been construed in Union of Concerned Scientists v. Nuclear Regulatory Commission, 824 F.2d 108 (D.C. Cir. 1987), discussed at text accompanying notes 57 - 61 infra.

[31] 49 U.S.C. §§304(a), (e).

[32] 15 U.S.C. §§1391-1431.

[33] 15 U.S.C. §1392.

Most of the statutes that are administered by the EPA similarly invite, but do not compel, attention to some of the elements of a cost-benefit analysis.[35] For instance, the agency interprets the statutory directive concerning primary National Ambient Air Quality Standards[36] to permit attention only to public health, and thus EPA sets these standards without consideration of analyses that evaluate costs or nonhealth benefits.[37] The agency, however, interprets the statutory mandate concerning establishment of performance standards for new stationary sources of pollution as requiring consideration of costs, but not air quality benefits. Thus, EPA sets the relevant standards after consideration of costs, cost-effectiveness, and economic impacts and not air-quality-related benefits.[38] Alternatively, EPA believes that it is permitted to consider all aspects of cost-benefit analysis in determining standards under the Uranium Mill Tailings Radiation Control Act, an amendment to the Atomic Energy Act. That broad-ranging amendment requires EPA to "consider the risk to the public health, safety, and the environment, the environmental and economic costs of applying such standards and such other factors as the Administrator determines to be appropriate."[39]

Judicial solicitude for strict agency cost-benefit analysis in the absence of an explicit legislative requirement was tested in a duet of Supreme Court cases, Industrial Union Department v. American Petroleum Institute[40] (the Benzene Case), and American Textile Mfrs., Inc. v. Donovan (the Cotton Dust Case).[41] In each case, the Court was considering whether standards promulgated by the Occupational Safety and Health Administration (OSHA) satisfied the statutory obligation of that agency to assure "to the extent feasible" that no employee would suffer material impairment of health or functional capacity.[42]

In the Benzene case, the Court considered whether a statutory directive that OSHA standards assure, as far as possible, that employees not be impaired by exposure to hazards precluded any cost-benefit analysis in the formulation of regulations. The agency had determined that, in the case of exposure to the carcinogen benzene, this directive required the most stringent limitation that was technologically and economically possible. Thus, cost-benefit analysis was unnecessary, if not outright prohibited. The Supreme Court, however, affirmed a determination by the Fifth Court of Appeals that some relationship between costs and benefits had to be made. While no opinion garnered a majority of the high court, a plurality did determine that the issue of how protective a standard should be imposed had to await a threshold determination of whether there existed a significant risk of material health impairment.

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[34] Letter of April 2, 1979, from Linda Heller Kamm, Department of Transporation, Office of General Counsel, to Ron Lewis.

[35] See Environmental Protection Agency, EPA's Use of Benefit-Cost Analysis: 1981-1986 at 3-1 - 3-7 (August 1987).

[36] Clean Air Act §109(b)(1).

[37] EPA, supra note 7, at 3-3.

[38] Id.

[39] Public Law 97-415, January 4, 1983. See EPA, supra note 7, at 3-7. EPA may consider all aspects of cost-benefit analysis under the similarly broad language of the Toxic Substances Control Act, 15 U.S.C. §§2601-2629, which permits consideration of health and environmental effects as well as economic consequences.

[40] 448 U.S. 607 (1980).

[41] 452 U.S. 490 (1981).

[42] 29 U.S.C. §655(b).

Though there were hints in the plurality and concurring opinions that cost-benefit analysis was congressionally mandated, and explicit statements in the dissent that reliance on cost-benefit was unauthorized, no final determination of the issue was made until the Cotton Dust Case. There the Court focused on the "feasibility" language of the statute and decided that that requirement displaced the obligation to undertake a cost-benefit analysis of a proposed regulation. Instead, a different, and presumably less rigorous, "feasibility" analysis was required. The function of the latter procedure was to determine that implementation of a proposed standard is "capable of being done."[43]

This semantic exercise, unfortunately, does little to displace the need for some comparative consideration of the costs and benefits of a proposed regulation. Numerous safety standards can be implemented at some cost, and are thus "capable of being done" within the narrow meaning of the Supreme Court's mandate. Less certain is whether the benefits obtained by implementing any standard are worth the associated costs. Unless the congressional directive is to take all precautions that are technologically possible, the absence of some standard by which to determine whether marginal advances in safety are worthwhile is likely to generate either overinvestment or underinvestment in accident avoidance from a societal perspective.

Our point at present, therefore, is to suggest that the obligation to consider values for human life is not only implicated where an agency is required specifically to compare costs and benefits. Statutory provisions may require particular attention to specific regulatory effects rather than a strict analysis that sanctions only those regulations whose benefits exceed costs. The FIFRA provision referred to above, for instance, requires the Administrator to take into account the impact of proposed final action on production and price of agricultural commodities, retail food prices, and the agricultural economy.[44] Similarly, where noncarcinogens are concerned, the Food and Drug Administration is required to determine whether food additives are "safe" for their intended use, a standard that does not necessarily implicate a finding of benefits in excess of costs or require banning additives whose costs exceed marginal benefits.[45]

Indeed, concerns for factors that might escape a naked comparison of costs and benefits have generated statutes that mandate reliance on less quantitative variables. For instance, the Federal Mine Safety and Health Amendments Act,[46] albeit less explicit than its predecessors,[47] demonstrated concern for the safety of miners by requiring closure of mines notwithstanding that the consequent costs might exceed expected losses to miners. Nor do these nonquantitative concerns consistently demonstrate solicitude for safety. Richard Merrill recounts congressional intervention to delay FDA programs designed to reduce the risk of adverse health effects related to shellfish, presumably to satisfy industry concerns.[48] While these programs may require that certain factors on either the cost or benefit side of the calculus be ignored, insofar as they eschew any absolute benchmark by which to determine the propriety of a particular regulation they require some synthesis of costs and benefits. Effective implementation of that mandate, therefore, requires some valuation of human costs saved or lost by the decision to regulate.

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[43] 452 U.S. at 509.

[44] 7 U.S.C. §136d(b).

[45] 21 U.S.C. §348(c)(3)-(4). See Merrill, supra note 25, at 999.

[46] 30 U.S.C. §§801-78.

[47] See Neely, Statutory Inhibitions to the Application of Principles of Cost/Benefit Analysis in Administrative Decision Making, 23 Duq. L. Rev. 489 (1985).

[48] See Merrill, supra note 25, at 1000.

Even the emerging judicial antipathy towards cost-benefit analysis does not preclude regulation predicated on some rational basis that includes human life valuations. This is most evident in recent decisions of the District of Columbia Court of Appeals that reflect inconsistent constructions of congressional grants of regulatory authority that affect human welfare.

In Natural Resources Defense Council v. EPA,[49] the District of Columbia Court of Appeals heard an appeal concerning standards for the emission of vinyl chloride promulgated by the Administrator of the EPA. Vinyl chlorides are carcinogens with no known threshold and a twenty-year latency period. Given the uncertainty of the hazards of a particular emissions level, the Administrator had required that emissions be reduced to the lowest level attainable by the best available control technology. The petitioner contended that the statutory basis for regulation, section 112 of the Clean Air Act,[50] precluded consideration of cost or technological feasibility. Instead, the petitioner argued, that provision, which requires emission standards be set at a level that creates "an ample margin of safety to protect the public health, "permitted consideration only of health-related factors. Thus, in the face of uncertainty, the Administrator was constrained to require a zero-emissions level.

In a decision by Judge Bork, a three-judge panel of the court upheld the authority of the Administrator to withdraw proposed regulations of vinyl chlorides by relying solely on economic and technological factors.[51] Congressional delegation of discretionary authority to the Administrator, in Bork's view, permitted the delegate to select the factors that would guide the exercise of that discretion. In a subsequent en banc decision also authored by Judge Bork, however, the court created a standard for "ample margin of safety" that precluded a strict cost-benefit analysis. The court adhered to the view that safety did not require zero-risk and thus dismissed the NRDC position. But it found that the Administrator could not simply define the appropriate margin of safety by reference to what was cost-effective; the Administrator was constrained by the primacy that Congress intended be given to health effects.[52] The court characterized the EPA's position as permitting a standard that would prohibit emissions to a point where marginal costs of additional controls exceeded marginal reductions in risk to health. Thus, definitions of "safety" were not made by reference to the Administrator's expertise, scientific risk assessments, or risks to health at particular emission levels, but only to a naked comparison of "technological and cost feasibility." The court rejected any such approach.[53] While the court was willing to permit consideration of these cost and technological factors, and specifically rejected the view that a "safe" level of emissions was one that was "risk-free," the court did mandate an initial, independent judgment of safety predicated on risks to health at particular emission levels.[54] Determinations of risks to health could be based on both scientific data and non-quantifiable factors such as risks deemed "acceptable in the world in which we live."[55] The "risk to health" decision, however, could not consider cost and technological feasibility. Nevertheless, once the safety threshold had been crossed, the Administrator could address remaining uncertainties by considering those economic factors in determinations of an "ample margin" of safety.[56]

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[49] 824 F. 2d 1146 (D.C. Cir. 1987)(en banc).

[50] 42 U.S C. §7412(b)(1)(b).

[51] 804 F.2d 710 (D.C. Cir. 1987).

[52] 824 F.2d at 1163.

[53] 824 F.2d at 1164.

[54] 824 F.2d at 1164.

The ability to engage in an explicit cost-benefit analysis became more doubtful under the approach taken most recently by the court in *Union of Concerned Scientists v. Nuclear Regulatory Commission*.[57] That case concerned the authority of the Nuclear Regulatory Commission to consider economic costs when deciding whether to require safety-enhancing modifications for previously licensed nuclear power plants. The Commission had proposed a rule that would require so-called "backfits" only when their direct and indirect costs were justified by a substantial increase in protection to health and safety.[58] Rather than accept or reject economic costs as the talisman for nuclear regulation, the court attempted a Solomonic compromise: economic costs could not be considered in determining whether regulation was necessary to satisfy the statutory mandate that the Commission provide "adequate protection" to public health and safety.[59] The Commission, however, could consider economic costs, "even to the extent of conducting strict cost-benefit analysis"[60] in establishing safety requirements beyond those necessary to meet the adequate safety requirements. Since the court understood that this interpretation meant that adequate protection was not synonymous with risk-free or absolute protection, the Commission presumably must engage in *some* sort of analysis of whether costs of regulation are worth incurring in order to render the level of safety "adequate." While the District of Columbia Circuit indicated that strict cost-benefit analysis is not appropriate to the task, and, indeed, has prohibited consideration of costs in the establishment of the adequate protection standard,[61] it seems logically impossible for the Commission to derive a standard of adequacy without paying some attention to the relative costs and benefits of a proposed regulation. To the extent that even"adequate protection" leaves some lives exposed, any meaningful decision concerning the desirability of a proposed regulation must implicitly, if not explicitly, value those lives relative to the cost of the proposal.

These recent cases suggest that application of cost-benefit analysis and the need for valuation of life to test the propriety of a regulatory effort are not coterminous. Even where courts have rejected the propriety of the former, they have not compelled regulations that create a "risk-free" society. The result is the need for regulations that provide "reasonable," "ample," or "adequate" levels of safety. Yet such phrases cannot be defined or applied without some reference to the relative effects of alternative policies. In a situation where human lives are put at risk, any such reference compels agencies to decide whether proposed standards will save sufficient lives to justify the associated expenditure. That justification may be predicated on considerations additional to technological or cost feasibility. But at some point, presumably most individuals in society would cease investing in safety. It is the derivation of that point that ultimately drives the quest for some valuation of life.

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[55] 824 F.2d at 1165.

[56] 824 F.2d at 1165 ("Once 'safety' is assured, the Administrator should be free to diminish as much of the statistically determined risk as possible by setting the standard at the lowest feasible level.").

[57] 824 F.2d 108 (D.C. Cir. 1987).

[58] 10 C.F.R. 50.109(a)(3) (1986).

[59] 42 U.S.C. §2232(a).

[60] 824 F.2d at 114.

[61] Id. at 119.

III. Issues in the Valuation of Human Life

A. Introduction

As we noted at the outset, our purpose in this report is to examine the processes through which government, implicitly or explicitly, values human life for purposes of regulation. Stating our purpose in this way, however, necessarily accepts the propriety of the effort at valuation and seeks only to refine it. Such a strategy threatens to ignore an important and cogent response to the entire effort at valuation, i.e., that any attempt to quantify the value of human life is inherently inappropriate, not because of the difficulty of the task or the intangibility of various factors that must be considered, but because the very process of quantification ignores and violates the sanctity of human life.

In its broadest formulation, the opposition to quantifying human life is based on the assertion that human life has a "sacred" value that cannot be reflected in monetized or quantified terms.[62] Douglas MacLean, a primary proponent of this view, means by this phrase that we adhere to certain ritualistic beliefs and practices in a manner that expresses "the special value of human life in our culture."[63] By so doing, we signal the community that saving lives has merit that exceeds even a precisely computed value. Any attempt to quantify human value is inconsistent with the symbols and rituals that we use to signal life's special meaning within the society.

Alternatively, commentators suggest that the very process of attempting to quantify the value of human life diminishes that value by suggesting that human life is exchangeable in a manner akin to commodities. Regardless of our ability to consider a commodity as a substitute for human life (one can, after all, compare apples and oranges), some suggest that there may be reasons not to admit our lack of uniqueness.[64] We may, for instance, wish to signal to ourselves the intrinsic worth of certain aspects of life in order to indicate that they are not reducible to monetized values. Such arguments have been put forward to explain a desire to invest in clean air beyond an optimal point.[65] We are, in this argument, entitled to "breathing rights" without making any purchase or engaging in conduct that gives rise to a claim of desert. Similarly, we may wish to signal similar entitlements to a "safe" life, a signal that would be subject to substantial static should we admit openly that life can be balanced against other resources. Such an admission necessarily dehumanizes the subject, and reifies the intangibles of life by placing them on a parallel with commodities subject to market transactions.

Finally, there is a concern that the very process of quantification alters the conclusions that one reaches about the value of human life and thus violates the precepts of neutrality that allegedly underlie any concerted effort to address the issue. For instance, some argue that attempts to quantify the value of individual lives necessarily treats individuals separate and apart from the communities in which they live and "reinforces self-interest as a correct or worthy index of value."[66] By this argument, perhaps understood as a special application of the Heisenberg uncertainty principle in which the measurement process affects outcome, the result would necessarily undervalue life by removing communal values from the process of isolating one individual's worth.

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[62] MacLean, Social Values and the Distribution of Risk, in D. MacLean, Values at Risk 85-86 (1986) (hereinafter, Social Values); MacLean, Comparing Values (unpublished manuscript).

[63] MacLean, Social Values, supra note 62, at 86.

[64] See, e.g., Solow, Defending Cost/Benefit Analysis: Replies to Steven Kelman, 5 Regulation 2 (May/June 1981).

[65] Tribe, Policy Science: Analysis or Ideology, 2 Phil. & Pub. Aff. 66, 88-89 (1972).

Notwithstanding the cogency of these remarks, we proceed, somewhat unabashed, to analyze efforts to value human life. Our failure to be convinced by the above arguments is based largely on the following responses. First, as a pragmatic matter, it is clear that -- even if we reject the assignment of explicit values -- we as a society constantly engage in the implicit valuation of human life.[67] When we create new technologies that are risk producing, whether they be new machines or drugs to combat disease, we know that the benefits of those technologies carry some degree of cost. Accidents in the production of those technologies, abreactions in consumers, and foreseeable injuries that will result from the negligence of users all reveal that these advances are not risk-free. Nevertheless, we proceed because we believe that even risky technologies may be (net) risk reducing, i.e., they may eliminate a greater quantum of risk than they create.[68] Even if they do not displace greater risks to human life, they may possess other compensating features, e.g., convenience, that offset the risks they pose. Thus, a social decision to proceed in the face of known risks reveals that we (a term that does not necessarily implicate governmental agencies although it has increasingly come to connote them) believe those risks that remain are "worth taking." To the extent that those risks involve threats to human life, we implicitly concur that the value of risks reduced exceeds the value of the lives lost. When we decide to regulate certain activities or not to regulate others, we are implicitly determining that the costs of regulation do or do not exceed the value of lives saved as a result of regulation.

Second, and related to the first, our implicit decisions about human life may be susceptible to some level of quantification. Presumably, we would desire to make the tradeoff between lives and other resources as accurately as possible. If that is the case, failure to attempt any such effort at quantification causes us to generate either too much or too little risk. While one may respond that such a belief ignores the lessons derived from the theory of the second best -- that in the absence of the ability to quantify all variables, it is not necessarily second best to quantify as many as possible -- that theory suggests only that second best solutions *may* not be preferable to inaction, not that they cannot be preferable.

Third, while there may be something invidious in the quantification process, e.g., in reifying human life or in risking the omission of nonquantifiable variables from the ultimate decision, we do not believe these effects to be inexorable. The effort at determining whether regulations are "worthwhile" in terms of cost per life saved is not necessarily dehumanizing if decision makers are ultimately attentive to both the valuation process and its limits. The desire to consider these factors may help to determine the identity of the ultimate decision maker. For instance, one may consider courts rather than agencies to be more receptive to nonquantifiable variables because courts regulate ex post and are faced with actual victims, whereas the ex ante approach of regulators necessarily limits them to statistical analysis.[69]

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[66] Swartzman, Sources of Controversy, in Cost-Benefit Analysis and Environmental Regulations: Politics, Ethics, and Methods 72 (1982).

[67] See, e.g., E. Stokey & R. Zeckhauser, A Primer for Policy Analysis 149-53 (1978); H. Rosen, Public Finance 193 (1985).

[68] See Grady, Why Are People Negligent? Technology, Nondurable Precautions, and the Medical Malpractice Explosion, 82 Nw. U. L. Rev. 293 (1988); Huber, Safety and the Second Best: The Hazards of Public Risk Management in the Courts, 85 Colum. L. Rev. 277 (1985).

Finally, at the very least, efforts at quantification provide regulators with a common metric and thus permit both regulators and those to whom they are accountable access to some measure of the consistency of regulatory action. If one agency refuses to propose regulations on the theory that they will be too costly at a rate of $X per life saved while another agency promulgates regulations that will cost $2X per life saved, those who analyze the regulatory process have a comparative basis for inquiring into the propriety of regulatory action. Similarly, Paul Rubin has suggested that explicit valuations may enhance regulatory goals of maximizing benefits to consumers for the level of spending that society is willing to invest in safety. Rubin suggests if an agency with a fixed budget can spend $20,000,000 on safety in a given year and can select either a method of safety that saves lives at a cost of $1 million per life or a method that saves lives at a cost of $2 million per life, explicit recognition of these values will increase total lives saved (by concentrating all resources into the first method) over random selection of the alternatives (e.g., by investing $10 million in the first method and $10 million in the second).[70] Implicit in this objective is the understanding that once part of our social budget is allocated to safety, it ought to be spent in a manner that maximizes the number of lives saved. This understanding is not necessarily tautological. There may be intuitions that lead us to favor spending in a manner inconsistent with maximum life saving.[71] Nevertheless, we might test the strength of these intuitions by determining how far they deviate from a principle of maximum life saving. In any event, the principle of maximum life saving poses substantial difficulty for the thought that life valuations are inconsistent with respect for the symbolic or sacred value of life. It would be somewhat anomalous to hold life sacred without simultaneously attempting to maximize the number of lives saved. Thus, even the sacredness approach may require some attention to the relative implicit values of regulation for health and safety.[72]

Our review of federal agency practices reflects these concerns. Not all agencies accept the view that valuation of human life is an appropriate governmental enterprise. The most forthright rejection can be found at the National Highway Traffic Safety Administration ("NHTSA"), despite its location within a department, the Department of Transportation, whose regulatory procedures call for quantitative benefits analysis (DOT's "Guidance for Regulatory Evaluations"). NHTSA strongly objects to full benefits analysis of fatality avoidance: "It should be noted that this Agency does not consider it appropriate to place a dollar value on human life or injuries."[73] NHTSA believes that it is useful to quantify the clearly monetizable consequences of accidents, particularly property damage, lost productivity, and medical and legal costs. It acknowledges that these constitute only a subset of all benefits from accident reduction, but it chooses not to value other benefits explicitly. It merely states the number of lives or injuries at risk.

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[69] See Gillette & Krier, Risk, Courts, and Agencies (unpublished manuscript 1988). See also text accompanying notes 125-34 infra.

[70] See Memorandum from Paul Rubin to Consumer Product Safety Commission, Feb. 25, 1986.

[71] See Fried, The Value of Life, 82 Harv. L. Rev. 1415, 1418 (1969).

[72] Id. at 1425.

[73] NHTSA, The Economic Cost to Society of Motor Vehicle Accidents 1-2, DOT HS 806342, January 1983.

Other agencies appear to use explicit values sporadically. For instance, memoranda from the Consumer Product Safety Commission reveal use of a $1-2 million valuation of life in discussions concerning regulation of disposable cigarette lighters and bunk beds.[74] Other memoranda reveal no explicit valuation of life, but only elaboration of the per life costs that would have to be incurred in a regulatory effort. For instance, discussions concerning a particular regulation assume a variety of accident avoidance measures with varying costs. On the assumptions stated in the discussion, these cost estimates range from $2.6 million to $312.5 million per life saved. While the discussion does not incorporate any assignment of value for life, one would infer that proceeding with the more expensive regulatory effort reflects a judgment that life is worth that much, while failure to utilize a more expensive alternative that would save more lives reflects a judgment that the expenditure is not justified, i.e., that saving the marginal lives is simply not worth the necessary added expenditure.

None of the above suggests that valuation is a task devoid of computational, ethical, or legal difficulties. Indeed, extraordinary difficulties in any of the above may render the results of any computation so suspect as to undermine the propriety of the effort. In the remainder of this report, we will investigate the extent of those difficulties. At this point we only conclude that those inquiries should not be precluded by any threshold aversion to quantification.

Nevertheless, there may be situations in which monetization of human life has little merit, given the computational and ethical difficulties associated with the project. For instance, where other factors of uncertainty are so dominant as to dwarf potential disagreements about values for life, paying much attention to the latter factor seems unproductive. Assume, for instance, that a particular regulation is anticipated to lessen a risk, but available scientific evidence is too weak to permit reliable quantification of the risk reduction. e.g., the evidence permits only a range of probable reduction at somewhere between 1:10,000 and 1:1,000,000. In this situation, application of a precise figure for human life to diffuse estimates of risk reduction will do little to resolve the question of the proposed regulation's cost-effectiveness. Thus, little is to be gained by evaluating the value of lives saved in this context alone. Short of such situations, however, we believe that the valuation process theoretically generates a more informed and effective decision basis for risk-reducing regulations.

B. Problems of Quantification.

If we knew with certainty the costs of regulation and the number of lives that could be saved by implementing any given proposal, quantifying the value of individual human lives would be unnecessary to achieve the most cost-effective level of regulation. Instead, we could determine an appropriate "life-saving budget" and adopt regulations seriatim, starting with the one that saved the most lives per dollar, until the funds allocated to life-saving were exhausted. Unfortunately, this felicitous scenario is unlikely to materialize as long as implementation costs are uncertain and are calculated differently across agencies. Indeed, even if we could impose some uniform calculus on agencies, we might fear that its wooden application would fail to recognize that we do not treat all deaths equally. Avoidance of cancer deaths might warrant expenditure of more resources than avoidance of an equal number of deaths in automobile accidents, simply because we dread the painful and extended deterioration that accompanies the former. Thus, some mechanism that reflects our treatment of different deaths should augment initial rankings of the "most effective" regulations.

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[74] See Memo from Dale Ray to Paul Rubin, May 5, 1987 (cigarette lighters); Memo from Dale Ray to David Thome, September 23, 1987 (bunk beds).

On its face, a procedure that values both the costs and benefits of regulation would appear appropriate. Any such procedure ideally would quantify all the consequences of implementing a particular level of life saving. Thus, it would permit a differentiated view of the effects of regulations not possible if all deaths are treated equally. Applying such a mode of analysis to the area of health and safety regulation, however, creates an additional set of difficulties. Cost-benefit analysis poses relatively little difficulty where components of the calculus constitute commodities that are exchanged at competitively negotiated prices in established markets or that are otherwise susceptible to socially acceptable quantification.[75] Thus, a decision by a rational, self-interested, profit-maximizing entity to invest in a device that will cost $X and will replace current production modes that cost $X+1 seems relatively straightforward. The difficulty that pervades cost-benefit analysis involving human life is the absence of any reliable "market price" that can be used as a standard for fair exchange. In the absence of a market, some alternative means must be found for establishing what we are willing to invest in order to save a human life. Human life has value not simply because of the ability of humans to produce goods that do have market values (a function that does permit some measure of the value of human life, often termed human capital[76]) but also because life generates additional values less susceptible to quantification. Within this category lie such factors as "community," "friendship," and the "hedonic" value of life.

In this section we consider the primary approaches that federal agencies have adopted to address this difficult issue of quantification. We trace the history of their use and the relevant methodology. Finally, we consider some of the critiques of each approach and attempt to reach some conclusions about whether those critiques are so substantial as to undermine any utility that the quantification effort might otherwise possess.

1. Initial Efforts; Human Capital Reasoning.

However one might choose to characterize its overall impact, loss of life does have the quite tangible consequence of lessened production and consumption of goods and services. This fact forms the basis for one longstanding approach to the valuation of life, which is often referred to as the human capital approach. Premature destruction of a productive machine would deprive society of whatever output it was capable of yielding over its remaining years of usefulness. The human capital approach relies on an analogy between such productive physical capital and the economic productivity of people. Thus, this approach equates the value of life with the dollar value of goods that can be produced by the person whose life is at risk. In particular, one can estimate the amount of future income that will be forgone if a person's productive effort comes to an early end due to death. This provides one measure of the value of a life.

The human capital concept is quite useful for a number of policy questions. For example, consider the issue of setting priorities for types of capital spending to stimulate economic growth. Not recognizing that human productivity can be increased by outlays on training could lead to an overemphasis on acquiring physical capital. Similarly, if one were concerned with the issue of optimal investment in life insurance to assure a suitable income stream in the event of one's death, a human capital approach would be appropriate.[77] Moreover, the concept has practical appeal -- say in debating the merit of further education -- both at the level of the identifiable individual and for large group decisions.

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[75] See Baram, supra note 15 at 483; Zeckhauser, Measuring Risks and Benefits of Food Safety Decisions, 38 Vand. L. Rev. 539, 544 (1985).

[76] See discussion at text accompanying notes 77-95 infra.

But in the context of fatality-risk reduction, human capital thinking can at best provide incomplete answers, as it considers only losses in national income and fails to consider other losses, including the at-risk individual's own desire to live.[78] Cutting short a human life has a significance that includes but transcends measurable output effects. Mishan reviews some of the early efforts to base life valuation on expected future earnings and identifies conceptual weaknesses.[79] For example, Mishan notes the commonly articulated but rarely satisfied need to buttress estimates of forgone earnings with values for consequences such as pain and suffering and family bereavement. As appealing as this might seem, it moves the analyst well beyond readily available and verifiable data sources. Other than jury verdicts relating to pain and suffering, there exists little basis to assess the amount of money that would compensate for suffering and bereavement.

On the other hand, restricting our measure to forgone earnings, while assuredly facilitating objective estimations, carries with it certain ethically troublesome implications. Any approach based on lost earnings will place low valuations on the lives of those who are neither wage earners nor producers of goods or services in developed markets, for example, retirees and homemakers (although markets have developed for some homemaking functions, e.g., child care and cooking). This can lead to any number of objectionable policy outcomes. Suppose two alternative strategies for hazard reduction would avert the same number of total deaths, but one would disproportionately benefit retirees (which could happen if the region benefiting most from one strategy had an older population). An application of a human capital approach to benefits valuation would make the latter strategy look less warranted. Yet few would find this an acceptable basis on which to make a choice between the two alternatives.[80]

Whether as a matter of social policy we would prefer the alternative that protects a more youthful subgroup may be an unavoidable decision. But using a monetization process that neglects everything but future individual productivity would not clarify or inform the decision; it would merely mask its real implications with the appearance of quantitative objectivity. The underinclusiveness of the human capital approach would be exacerbated if it systematically excluded or undervalued particular components of a "valuable" life. The approach appears to suffer from just such a defect insofar as it provides no mechanism (such as shadow prices) for losses that are unrelated to production or market forces and that are, therefore, difficult to quantify. Examples include pain and suffering, psychic harms, and dread of catastrophic or involuntary risks.

Additionally, human capital approaches may incorporate invidious social effects that reflect lower productive values for persons kept from highly productive jobs for reasons

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[77] See L. Dublin & A. Lotka, The Money Value of a Man (1930); M. Jones-Lee, The Value of Life: An Economic Analysis 21-22 (1976); Linnerooth, The Value of Human Life: A Review of the Models, 17 Econ. Inquiry 52, n.1 (1979).

[78] Id. at 53.

[79] E. Mishan, Cost-Benefit Analysis 320-45 (3d ed. 1982).

[80] This is not to suggest that alternative methodologies are free of such skews. For instance, in a willingness-to-pay approach, discussed infra, it might be that younger people would be willing to pay more than older people to avoid risks of fatality. Cf. Arthur, The Economics of Risks to Life, 71 Am. Econ. Rev. 54 (1981).

having little to do with ability to perform those jobs. For instance, assume that a segment of the population is the subject of employment discrimination. Thus, members of this segment either cannot obtain certain jobs or can obtain them only by accepting a wage less than that of similar workers outside the discriminated group. Assume further that this group is found to be particularly susceptible to a certain disease or injury (e.g., sickle-cell anemia for blacks, Tay-Sachs disease for Jews, breast cancer for women). Finally, assume that these risks could be avoided at a cost of $X. If $X is weighted against the human capital costs of the at-risk group, without taking into account the effects of invidious discrimination on the productive capacity of the group, then the cost effectiveness of the curative will be grossly understated.[81] One variant of the human capital approach common in highway policy circles until 1984 employed an even more offensive assumption that the value attached to a life (reflecting future wages) should be lessened by that individual's future consumption.[82] Then having in the analyzed group some elderly people who consume but do not work would have the bizarre effect of actually valuing certain deaths positively.

Notwithstanding these critiques, human capital approaches provide the benefit of administrative ease.[83] Actuarial tables provide justifiable estimates of life expectancy and projected earnings for those placed at risk. In addition, the ethical concerns have not been so strong as to preclude the widespread use of human capital approaches in a variety of situations. Perhaps most commonly, expected earnings remains the primary component of compensation in wrongful death actions in the judicial system.

In summary, the human capital approach appears most objectionable for its exclusion of factors relevant to value that are not easily translated into terms of productive capacity. Advocates of cost-benefit analysis are not oblivious to these concerns about variables that resist quantification. The response, however, seems largely to take two forms. One is urging those who employ cost-benefit analysis to be sensitive to additional variables not considered in the quantification process. The other is to separate formally the process of quantification from decision making, or risk assessment from risk management.[84]

Unfortunately, neglect at quantification stages of what Lawrence Tribe early described as "soft variables" may preclude their subsequent reintroduction into the policy decision.[85] Decision makers who would ideally reconcile quantifiable data and more ephemeral considerations may be driven by the "hardness" of the former and the abstraction of the latter to rely solely on the data. Quantifiable variables give the decision maker something concrete to point to in order to justify a particular decision and create an impression of scientific impartiality and certainty. Simultaneously, reliance on quantifiable variables, such as expected earnings over a given number of years in a particular occupation, avoids the need to consider other values that compete with economic utility. Thus, Thomas Nagel writes that attempts to resolve conflicts by reference to a single general system, e.g., a quantitative one, bars as "irrelevant or empty all considerations that cannot be brought within the scope of that system."[86]

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[81] See Acton, Measuring the Monetary Value of Lifesaving Programs, 40 L. & C. Prob. 46, 55 (Autumn 1976); Rice & Cooper, The Economic Value of Human Life, 57 Am. J. Pub. Health 1954, 1960 (1967).

[82] Miller, Accident Costs and Safety Policy Decisions, unpublished paper, January 12, 1986 at 2.

[83] See Acton, supra note 81, at 52; Arthur, supra note 80, at 54, Cook, The Value of Human Life in the Demand for Safety: Comment, 68 Am. Econ. Rev. 710 (1978).

[84] See Ruckelshaus, Risk in a Free Society. On this view, risk assessment is a neutral process, informed solely by pure and objective scientific investigation and measurement. Risk managers, on the other hand, filter the objective data provided by risk assessment through their political roles to determine the proper social policy. Commentators have recognized the difficulty of separating these functions. Uncertainties inherent in the scientific investigation, degrees of confidence in results, and ranges of probability that risks will materialize all raise risk assessment issues that can only be resolved through incorporating the values of the investigator. See Latin, Good Science, Bad Regulation, and Toxic Risk Assessment, 5 Yale J. Reg. 89 (1988).

Indeed, to some extent, legal doctrine invites regulators to ignore certain "soft variables," notwithstanding the very real costs that they involve. For instance, the Supreme Court has determined that the National Environmental Policy Act of 1969[87] did not require the Nuclear Regulatory Commission to evaluate psychological effects on nearby residents prior to approving operation of the Three Mile Island nuclear power plant after a major incident at that facility.[88] Although the Court recognized the existence of such effects, it determined that the statute addressed solely effects of conduct on the physical environment rather than to perceptions of risk.[89]

There is some evidence that soft variables or those external to the general system do not get completely ignored. Social or political values may cause regulators to resist decisions that appear mandated by reference to quantified values alone. Some commentators have explained this phenomenon by reference to the existence of "trumps" in the risk management process.[90] But given the politics of regulation, intervention of trumps would seem fortuitous rather than systematic. Their introduction may depend on whether the affected population has sufficient political power to persuade legislators or regulators of the need for or inappropriateness of regulation. Political capacity may turn on such issues as discreteness of injury and diffusion of the affected population rather than on any merit-based criterion. Thus we are left with a general concern that quantifiable variables take on a life of their own and override other, less quantifiable concerns. Leonard and Zeckhauser similarly suggest that these effects are inevitable.[91] They take comfort, however, in the fact that the skews are not unidirectional. They state:

> But this limitation is itself ethically neutral unless it can be shown that the quantifiable considerations systematically push decisions in a particular direction. In other words, it is not sufficient to argue that cost-benefit analysis does not handle perfectly what is obviously a very hard task; rather, its detractors must show that its errors are systematically unjust or inefficient -- for example, that it frequently helps the rich at the expense of

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[85] Tribe, supra note 65. See also Michelman, Norms and Normativity in the Economic Theory of Law, 62 Minn. L. Rev. 1015 (1978).

[86] Nagel, Fragmentation of Value 137, in T. Nagel, Mortal Questions (1979).

[87] 42 U.S.C. § 4321.

[88] Metropolitan Edison Co. v. People Against Nuclear Energy, 460 U.S. 766 (1983).

[89] The Court did suggest that risk perception raises an issue of whether a particular technology should be utilized. 460 U.S. at 776. The Court held, however, that any such issue was not implicated in the statutory issue before it.

[90] Leonard & Zeckhauser, Cost-Benefit Analysis Applied to Risks: Its Philosophy and Legitimacy 31-42, in D. MacLean, Values at Risk (1986).

[91] Id. at 44-45.

> the poor, or that the environment is systematically disadvantaged to the benefit of industry. We have not seen any carefully researched evidence to support such assertions.[92]

Three problems exist with this reasoning. First, those errors that exist do not necessarily cancel each other out. If two decisions are made, one of which adversely affects the rich and the other of which adversely affects the poor, there is no reason to believe that the same parties will be affected or that the inefficient or unfair effects of each decision will precisely (or remotely) offset the other. Second, it is unclear why the burden of proof is on the dissenters. Why not place it on those who desire to use cost-benefit rather than on those who oppose it? Given uncertainty about the validity of an analytical tool, placement of the burden of proof may be determinative of outcome. While there may well be substantial ethical and pragmatic justifications for using some form of cost-benefit analysis, it is unclear why they need not be explicitly proffered by those who would employ such methods. Third, the discussion implies that the process of risk assessment is readily separable from that of risk management. On this view, risk assessors are apolitical technocrats who generate quantitative data based on value-neutral processes and deliver it in pristine fashion to political decision makers.[93] These risk managers then filter the information through a political process that responds to political trumps. Unfortunately, this ideal remains distant from the actual process of risk assessment. As we shall discuss later in this report, political and scientific values are inherent in the decisions of risk assessors to employ certain test procedures, to present data in certain forms, and to select or ignore certain hypotheses. Thus, what risk managers receive, and what they can therefore subject to political trumps, has already been filtered through a rigorous value system.

2. Toward Willingness-to-Pay Approaches.

The inherent limitations on the utility of human capital approaches have led policy makers to seek more acceptable alternatives to the valuation of life. Following a 1968 article by Thomas Schelling,[94] researchers have seized on a theory of valuing life by determining what individuals would be willing to pay in order to reduce the probability of death or what they would accept to have that probability increased.[95] This method, known as the willingness-to-pay approach, assumes that one can get a sense of how people will value a small reduction in the risk of accidental death by examining their behavior in the marketplace. To the extent that it is successful, the willingness-to-pay approach avoids many of the obstacles associated with human capital valuations. For instance, willingness-to-pay assumes that people internalize the "soft variables" excluded from the human capital approach and that they express a monetized value for those factors, e.g., concern for pain, dread of particular types of death, in their marketplace choices for goods, services, and occupation. Additionally, willingness-to-pay provides the normative appeal of consistency with individuals' preferences.[96] People may incorporate into their responses to willingness-to-pay inquiries factors such as the nature of the risk they confront (e.g., voluntary vs. involuntary) and the type of death (prolonged agony or quick and painless) they will suffer should a risk materialize.[97]

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[92] Id. at 44.

[93] See Rowe, Government Regulation of Societal Risks, 45 G.W.L. Rev. 944 (1977).

[94] Schelling, The Life You Save May Be Your Own, reprinted in T. Schelling, Choice and Consequence 113 (1984).

[95] Conley, The Value of Human Life in the Demand for Safety, 66 Am. Econ. Rev. 45 (1976); Dardis, The Value of Life: New Evidence from the Marketplace, 70 Am. Econ. Rev. 1077 (1980).

Operation of the willingness-to-pay approach is illustrated in EPA's 1983 review of the literature. If, for instance, an individual voluntarily takes precautionary steps that cost $10 and reduce the probability of death in a particular situation from 10 in a million to 5 in a million, then the implied value of life can be computed as $10/.000005 = $2 million.[98] The data most commonly relied on for these purposes are drawn from labor market studies of the wage premium observed in comparisons of jobs varying in their fatality risks (using multivariate regression analysis to isolate the influence of risk). However, other data sources also have been tapped. For example, some studies have drawn inferences from consumer choices ranging from seat belt usage to willingness to take risks through speeding or not using crosswalks (sometimes called hedonic approaches to willingness to pay) and from consumer behavior in the selection of relatively risky products.[99] Others have relied on surveys of consumer attitudes toward actions that lessen risk (sometimes referred to as contingent valuation approaches to willingness-to-pay).[100]

Numerous willingness-to-pay studies have been completed. Viscusi concludes that for typical risk situations, a range of about $2-3 million can be defended, as can higher values for involuntary risk situations. Miller finds credible values of $1.4 million plus or minus 40%.[101] The Environmental Protection Agency's own conclusions about value of life are more guarded, suggesting a range of $400,000 to $7 million in 1982 dollars.[102] Elsewhere, however, EPA staff have suggested $1.5 to $2 million as a reasonable norm,[103] and an EPA staff draft recently identified $1.6 million to $8.5 million as supportable.[104]

3. The Limits of Willingness-to-Pay.

Economic reasoning suggests that willingness-to-pay is theoretically superior to the human capital approach to valuing human life. A person's willingness to pay to avoid a risk presumably incorporates that individual's valuation of factors that are difficult to measure independently, and thus this approach necessarily considers nonquantifiable variables that cost-benefit analysis is typically accused of ignoring. For instance, consider an individual who could purchase either of two gasoline lawn mowers that are identical in all respects other than that one of them contained a one-gallon tank of gas and the other contained a two-gallon tank. If a consumer were willing to pay $10 more for the latter, we could infer that the convenience of less frequent fillups was worth $10 to that consumer. Thus, we could quantify a soft variable, convenience, that is easily overlooked and for which there is no market for exchange from which to derive an explicit value. Similarly, willingness-to-pay may reveal values for aspects of safety not otherwise readily quantifiable.

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[96] For a formal exposition of the assumed decision process involved in deciding the value of reducing risk of death, see Jones-Lee, The Value of Changes in the Probability of Death or Injury, 82 J. Pol. Econ. 835 (1974).

[97] See Acton, supra note 81, at 50-51.

[98] EPA, supra note 7, at 1-2.

[99] For a survey of different studies, see EPA, supra note 7.

[100] For an analysis of the credibility of questionnaires and surveys, see Jones-Lee, Hammerton, & Philips, The Value of Safety: Results of a National Sample Survey, 95 Econ. J. 49, 66-71 (1985). The authors report mixed results concerning the veracity and rationality of responses, but find that results from questionnaires concerning the value of life parallel results obtained through revealed preference studies, i.e., about £1.25 million in 1981 prices. See id. at 71.

[101] Miller, supra note 82, at 15.

[102] EPA, supra note 7, at 6-3.

[103] Luken, National Research Council at 13.

[104] See note 11 supra.

This advantage of the willingness-to-pay approach, however, should not be understood as a panacea for the problem of the immeasurable. The limitations of willingness-to-pay fall into several general categories. The first is mobility. Information extracted from labor studies must assume jobs and wage rates that are accepted volitionally, without exogenous constraints. In fact, however, jobs and wage rates may be accepted under conditions in which alternatives are restricted by mobility or cultural considerations that limit the horizons of workers.

The second problem is informational. Willingness-to-pay serves as a useful measure of value only where the expressed preferences are based on knowledge that accurately reflects both the payer's probability of death and the losses that will occur should that risk materialize. The need for such information suggests that willingness-to-pay approaches may be of limited utility where actors are ignorant of or systematically miscalculate the relevant variables. Because this information may be difficult to obtain, investment in search may be rational only where decisions that incorporate the information occur with some regularity. In short, repeat players may be willing to obtain the relevant information, while single- or infrequent-play players may not. For instance, individuals may want to seek out risk information in decisions to engage in particular occupations, since those risks will be confronted continuously during the course of employment. Thus, Viscusi and O'Connor report that chemical workers perceive occupational risks that do not deviate significantly from objective measures.[105] A consumer considering which hedge trimmer to purchase, however, may avoid inquiries into relative risk among models as the search for that information will seem too costly given the infrequent use the consumer expects to make of the product. Indeed, there exists some evidence that regulation may (perversely) *enhance* tendencies to ignore risks. Viscusi notes a lack of "clearcut evidence of a significant beneficial effect on product safety" from Consumer Product Safety Commission regulations, some of which were intended to convey information to consumers. Indeed, accidental poisonings, Viscusi finds, did not decrease after the advent of safety caps, perhaps because of a "lulling effect" that regulation had on risk perception.[106]

Even if they are more likely to consider risks, repeat players such as employees may be subject to other biases that cause them to misapprehend the level of risk to which they are exposed and thus to misstate what they would be willing to pay or accept to reduce that risk. The literature of cognitive dissonance suggests that those who find themselves in risky situations without an easy way of escape are prone to deny the existence of the risk.

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[105] Viscusi & O'Connor, Adaptive Responses to Chemical Labeling: Are Workers Bayesian Decision Makers?, 74 Am. Econ. Rev. 942 (1984).

[106] Viscusi, Consumer Behavior and the Safety Effects of Product Safety Regulation, 28 J. L. & Econ. 527 (1985).

Any alternate view would require the actor to recognize that he or she has made a choice that is inconsistent with the actor's preference for thinking well of himself or herself, e.g., that the actor made a decision about employment that is personally safe.[107] Note that this phenomenon is likely where actors discover risks of choices previously made; known risks of future projects can be factored into the the decision whether to undertake the project. Nevertheless, where workers become aware of risks that attend the jobs they have held, or become aware of risk-reducing technology that they could employ at their jobs, they may fail to adjust their behavior to take into account the risks or the new technology.[108] Similarly, they are likely to understate their willingness to pay to avoid those risks, as such payments would implicitly recognize the hazards of their occupation. Thus, willingness-to-pay evidence obtained from such individuals cannot be equated with rational decisions about the value one places on one's life.

The third problem of willingness-to-pay is the presence of externalities. Even an accurately computed willingness-to-pay amount predicated on all available information will reflect only those losses that the payer seeks to avoid. Thus, externally imposed losses, e.g., losses suffered by those other than the payer and his or her immediate family, may not be reflected in the calculation at all. Assume, for instance, that an individual is willing to take a slightly more risky job, but only if it pays a somewhat higher wage. The wage differential will reflect the value to the worker of the change in risk of death. If the worker were to fall victim to an accident of the type that made the job risky, however, all the consequent losses might not be internalized by the worker. While the potential loss shared by close relatives and friends might be reflected in the worker's decision, and the loss felt by the employer might be reflected in market transactions with consumers of the goods produced by the employer, the loss felt by others -- co-workers, more distant relatives and acquaintances -- would not be reflected in the worker's calculations at all. Nevertheless, these individuals could feel real and substantial losses. Thus, the willingness-to-pay approach, while generally rendering a higher value for life than the human capital approach, will systematically undervalue life.[109] On an alternative view, however, externalities will lead to systematic overvaluation. Individuals will not, in valuing their own lives, consider the benefits conferred on others in the form of increased opportunities for consumption as a result of the death of a would-be consumer.[110] This view, however, fails to balance increased consumption against decreased production which may also follow from the death of one of society's members.

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[107] See Akerlof & Dickens, The Economic Consequences of Cognitive Dissonance, 72 Am. Econ. Rev. 307, 308 (1982).

[108] Id. at 316.

[109] We are not here concerned with a second type of external effect, i.e,. the failure of wage rates to reflect risks of death that workers may impose on others. For instance, the Environmental Protection Agency's analysis of vinyl chloride, discussed above, was based on additional cancers that would be suffered by residents living near plants rather than by workers. It is unlikely that even fully informed employees not at risk would demand wages that reflected risks imposed on non-workers. To the extent that those at risk are not consumers of the risky product, consumer prices are similarly unlikely to reflect amounts that those at risk would be willing to pay to avoid a hazard. Nevertheless, those at risk would presumably be willing to pay something to reduce their risk, if only there were a market in which they could effect the transaction. In a recent article, Viscusi, Magat, & Forrest, Altruistic and Private Valuations of Risk Reduction, 7 J. Pol. Anal. & Management 227 (1988), the authors relate evidence that individuals are willing to act altruistically to reduce risks to others. The level of altruism, however, is limited and dissipates with the geographical distance between the actor and the beneficiary.

[110] See Arthur, supra note 82, at 62.

Some risks present both the externalities problem and the informational problem. For instance, the Nuclear Regulatory Commission must determine whether proposed measures are necessary to ensure "adequate protection" of human health from the risks created by nuclear power plants.[111] A willingness-to-pay basis for measuring the cost effectiveness of a proposed improvement would confront two difficulties. First, those affected by a nuclear accident will not necessarily be limited to "expert" workers or others who have information about the risk they face. Thus the low probability of such an accident is likely to distort the relationship between expressed willingness-to-pay and the actual risk. Second, any such accident will likely generate substantial external effects that will not be included in willingness-to-pay evidence. The person placed at risk will not necessarily discriminate between the consequences of death in a nuclear holocaust and death in an automobile accident. Either case poses similar consequences for friends, relatives, and others who depend on the victim. The former risk, however, constitutes a catastrophe that threatens additional injuries through the loss of community, monumental stresses on medical and social facilities, and the possibility of substantial economic dislocations in the larger society.[112] While some have suggested that catastrophe poses no greater costs than the aggregate of an equivalent number of individual losses,[113] there is evidence that total losses are greater in the former case.[114]

Infrequency of exposure suggests the fourth problem of the willingness-to-pay approach: cognitive limits on the information utilized in the underlying calculus. For the most part, the risk of death related to products or to occupations is quite small. Infrequency does not affect either the desirability of considering the risk or the technical ability to calculate its value.[115] Even with small risks, expected losses can be derived by multiplying the probability times the loss that will occur should the risk materialize. Expected utility theory suggests that rational decision making would be guided by these precepts.[116] Developments in cognitive theory, however, suggest that individuals seriously deviate from results dictated by expected utility theory where probabilities are small.[117] These errors may at times generate underassessment of a risky event's occurrence and at times may generate overassessment. If the risk is not salient to the actor, as may be the case where injuries materialize only after significant latency periods, then actors are unlikely fully to consider the risk in determining what wage to demand in return for the exposure. This may particularly be a problem where risks are infinitesimal, notwithstanding that they create substantial losses should they, in fact, materialize.

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[111] 42 U.S.C. §2232(a).

[112] See Spangler, A Critique of Methods in the Quantification of Risks, Costs and Benefits in the Societal Choice of Energy Options 119, 125, in 10 Annals of Nuclear Energy (1983).

[113] See Nichols & Zeckhauser, The Perils of Prudence, Regulation, Nov./Dec. 1986 at 23.

[114] See, e.g., K. Erikson, Everything in its Path: Destruction of Community in the Buffalo Creek Flood (1976); Rabin, Dealing with Disasters: Some Thoughts on the Adequacy of the Legal System, 30 Stan. L. Rev. 281 (1978); Rosenberg, Class Actions for Mass Torts: Doing Individual Justice by Collective Means, 62 Ind. L. J. 561, 576-77 (1987).

[115] On the error of ignoring remote probabilities, see D. Parfit, Reasons and Persons 73-75 (1986); Shrader-Frechette, Parfit and Mistakes in Moral Mathematics, 98 Ethics 50, 54 (1987).

[116] See K. Arrow, Essays in the Theory of Risk-Bearing 52-68 (1974).

[117] See, e.g., Ayres & Sandilya, Catastrophe Avoidance and Risk Aversion: Implications of Formal Utility Maximization, 20 Theory and Decision 63 (1986); Dardis, supra note 95, at 1081 (realizing limits to model that would require individuals to distinguish between

If, on the other hand, the actor can readily call to mind examples of a risk's materialization, the actor is likely to demand compensation in excess of the expected loss of the risk. In this latter situation, known in cognitive theory as the "availability" heuristic,[118] the actor may designate recent or easily recalled events as common, notwithstanding that their appearance does not affect their statistical infrequency. Whether risks are recalled with too much or too little frequency, it can be anticipated that the expressed willingness of individuals to pay to avoid the risk will fail to reflect the actual probability of the risk and will thus deviate from what those same individuals would have been willing to pay had they been cognizant of more accurate probabilities. Here again, there is some evidence that those with frequent exposure to risks or information about risks ("experts") may more accurately predict the probability that a remote risk will materialize. Thus, willingness-to-pay evidence may be more credible when derived from experts than from those whose data base is suspect.[119]

Some of the biases inherent in evaluating infrequent risk may be avoided by questionnaires that make the risks salient to the respondent.[120] This possibility, however, creates an additional danger of the willingness-to-pay approach -- one related to the manner in which risks are presented to respondents. Individual preferences for particular actions may depend on the context in which a decision arises or the manner in which a particular decision is framed. The acceptability of social policies may even vary depending on whether the results are classified in terms of lives lost or lives saved, notwithstanding that the social consequences are identical in each case.[121] Additional biases may be apparent if

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probability reductions of 2 x 10^{-6} and 4 x 10^{-6}); Kahneman & Tversky, Prospect Theory: An Analysis of Decision Under Risk, 47 Econometrica 263 (1979). But see Brookshire, Thayer, Tschirart & Schulze, A Test of the Expected Utility Model: Evidence from Earthquake Risks, 93 J. Pol. Econ. 369 (1985) (property values in California reflect reaction to low-probability risks consistent with expected utility model).

[118] Tversky & Kahneman, Judgment Under Uncertainty: Heuristics and Biases, 185 Science 1124, 1127 (1974); Taylor, The Availability Bias in Social Perception and Interaction 190, in D. Kahneman, P. Slovic & A. Tversky, Judgment Under Uncertainty: Heuristics and Biases (1982). For applications to legal theory, see Gillette, Commercial Rationality and the Duty to Adjust Long-Term Contracts, 69 Minn. L. Rev. 521 (1985); Robinson, Rethinking the Allocation of Medical Malpractice Risks Between Patients and Providers, 49 L. & C. Prob. 173 (Spring 1986); Schwartz & Wilde, Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests, 69 Va. L. Rev. 1387 (1983).

[119] See Slovic, Fischhoff, & Lichtenstein, Facts & Fears: Understanding Perceived Risk 182, 191-92, in R. Schwing & W. Albers, Societal Risk Assessment: How Safe is Safe Enough? (1980).

[120] See, e.g., Acton, supra note 81, at 62-64.

[121] Tversky & Kahneman, The Framing of Decisions and the Psychology of Choice, 211 Science 453 (1981). In this work, the authors relate an experiment in the consequences of framing in which a group of students were asked to choose between two alternative programs to combat an expected outbreak of a disease from which 600 people would die unless one alternative program was adopted. The first alternative was stated as one that

we relax the assumption, implicit in the analysis to this point, that methods of valuation that seek to assess what an individual would be willing to pay to decrease a risk of death (e.g., consumer product studies) are functionally equivalent to methods that seek to discern what an individual would demand in order to take an increased risk of death (e.g., labor market studies for risky jobs). Contrary to this assumption, some research suggests that individuals may value resources differently depending on whether they are paying to obtain an entitlement (receive a gain) or demanding compensation for the surrender of an existing entitlement (avoid a loss). If the entitlement had a constant value, an individual would demand as compensation an amount equivalent to what the individual would be willing to pay to maintain the resource. But there is evidence that individuals have asymetric attitudes towards gains (or maintaining the status quo) and losses.[122] Thus, an abutter of a pristine lake might demand more of a potential polluter than the same person would personally spend to maintain a clean lake.[123]

The implications of deviations between "offer" (purchase) prices and "asking" (compensation) prices for valuation procedures are theoretically quite substantial. Since asking prices generally exceed offer prices, labor market studies that measure wage premiums for exposing oneself to additional risk would be expected to state values higher than those derived from studies of what consumers would pay for safer products or more adequate warnings. In fact, however, studies of consumers and workers differ in methodology sufficiently to call into question whether mortality risks are being valued differently because of the perspective of the evaluator or the appraisal method utilized. Thus, even the same investigator may apply different investigative techniques that explain variations in results.[124]

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would save 200 people while the second alternative was stated as one that caused a 1/3 probability of saving 600 people and a 2/3 probability of saving no one. Seventy two percent of the group chose the first alternative. Another group was presented with the same threat and the following alternatives: one that would cause 400 deaths and one that created a 1/3 probability that nobody would die and a 2/3 probability that 600 people would die. Seventy-eight percent of this group selected the second alternative. See Tversky & Kahneman, Rational Choice and the Framing of Decisions, 59 J. Bus. S231 (1986). But see Fagley & Miller, The Effects of Decision Framing on Choice of Risky vs. Certain Options, 39 Org. Behav. & Human Decision Processes 264 (1987) (concluding that effect of framing may be less robust than previously reported).

[122] Empirical data to support the disparity is offered in Knetsch and Sinden, Willingness-to-Pay and Compensation Demanded: Experimental Evidence of an Unexpected Disparity in Measures Value, 99 Q. J. Econ. 507 (1984). See Kelman, Consumption Theory, Production Theory, and Ideology in the Coase Theorem, 52 S. Cal. L. Rev. 669 (1979); Hoffman & Spitzer, A Reply to Consumption Theory, Production Theory, and Ideology in the Coase Theorem, 53 S. Cal. L. Rev. 1187 (1980).

[123] See A. Polinsky, An Introduction to Law and Economics 123-26 (1983); Note, An Economic Analysis of Tort Damages for Wrongful Death, 60 N.Y.U.L. Rev. 1113, 1122-27 (1985).

[124] See, e.g., Moore & Viscusi, Doubling the Estimated Value of Life: Results Using New Occupational Fatality Data, 7 J. Pol. Anal. & Man. 476 (1988) (using new series of data that increases implied value of human life). Viscusi's work on consumer risk valuation concentrates on morbidity or injury risk rather than mortality risk. See, e.g., W. Viscusi & W. Magat, Learning About Risk: Consumer and Worker Responses to Hazard Management (1987); Viscusi, Magat, & Forrest, Altruistic and Private Valuations of Risk Reduction, 7 J. Pol. Anal. & Man. 227 (1988).

Neither the offer nor the asking price necessarily represents a "correct" value of life.[125] Agencies could, of course, incorporate different values for different regulatory schemes. Thus, a regulation that required warning labels for risky products might be cost-effective at a level lower than a regulation governing clean-up of toxic waste dumps, even though the number of lives at risk was the same in the two cases. Alternatively, regulations that are cost-effective from one perspective might not be cost-effective from the other. Assume, for instance, that offer prices imply a value of life in the $1-2 million range while asking prices imply a $3-4 million figure. A regulation that cost $2.5 million per life saved would only be implemented on pure cost-benefit reasoning if the latter figure were used. Obviously, this problem increases with the magnitude of the variation in offer and asking prices. Minor variations are unlikely to render the efficiency of a proposed regulation dependent on the selection of a maintenance or compensation standard for valuing lives.

4. Ex Ante/Ex Post Losses and the Use of Jury Awards.

Our discussion to this point has underscored one particular feature of hazard rulemaking -- its focus on statistical lives. That is to say, these rules recognize that a particular activity puts life at risk; based on historical experience, projections can be made concerning the number of lives so risked. Administrative regulation, however, takes place ex ante, before any of the people actually placed at risk can be identified individually. Although ex ante regulation may be able to narrow the group from which the ultimate victims will come, e.g., workers in a particular industry or consumers of particular products, we cannot more precisely predict who will fall victim to society's desire to pursue the activity, notwithstanding its inevitable human cost. It is within this context that regulators assign values to life and consider the offsetting benefits.

Once the risk materializes, however, we typically are able to identify the individual victim. At this point, a particular application of the "soft variables" discussed above comes into play. Once we must make a decision ex post whether to save an individual life, we do not withdraw to a naked statistical analysis of the cost effectiveness of the effort. Certainly, our attitude is not, "if the risk was not worth saving prior to its materialization, it is not worth saving now." Instead, we appear willing to invest almost limitless resources in saving identifiable individuals who, from an ex ante perspective, were not worth saving from exposure to risk. Readily available examples include miners trapped in mines that might have been made safer (at a cost earlier deemed unwarranted), earthquake victims buried under the rubble of buildings (previously considered safe enough), or children trapped in wells (theretofore considered not worth plugging). Numerous commentators have suggested that the kinds of regulatory calculations that generate safety and health standards have no applicability to these ex post cases.[126] We seem not only to recognize the "sacred value" of human life when it is made so salient. We may also be moved by some sense of equity to attempt a rescue the cost of which exceeds the ex ante statistical value of the victim. Having rejected (at least implicitly) precautionary action as too costly, we subsequently have a particular threatened victim on our hands. Once we know who must pay the cost of conferring the benefits (namely, avoiding costs of ex ante reduction of hazards) on the rest of us, it seems appropriate to reduce the burden to that threatened victim, especially when we can do so without losing all the benefits that we have captured by imposing the obligation to sacrifice on some theretofore anonymous victim. It may well be for these reasons that the Environmental Protection Agency, in its thorough 1983 survey of risk reduction valuation approaches, states that: "(a)lthough there is not a clear consensus in the literature, the arguments for the use of ex ante, unidentified risk valuations in policy evaluation are persuasive."[127]

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[125] For discussions of the offer-asking problem, see Carlson, Reforming the Efficiency Criterion: Comments on Some Recent Suggestions, 8 Car. L. Rev. 39 (1986); Kennedy, Cost-Benefit Analysis of Entitlement Problems: A Critique, 33 Stan. L. Rev. 387 (1981); Markovits, Duncan's Do-Nots: Cost-Benefit Analysis and the Determination of Legal Entitlements, 36 Stan. L. Rev. 1169 (1984).

[126] See Calabresi & Bobbit, Tragic Choices (1978); Sagoff, Sense and Sentiment in Occupational Safety and Health Programs, 179, 183, in D. Nelkin (ed.), The Language of Risk: Conflicting Perspectives on Occupational Health (1985); Schelling, supra note 94.

This ex ante/ex post distinction suggests why jury verdicts and settlements in wrongful death cases might be an inappropriate basis for regulatory life valuations. Those awards focus on the particular earnings and family situation of a known individual, for quite plausible reasons. It is commonplace in these proceedings for evidence on income loss to figure importantly in outcomes. Yet certain factors imply that juries would use their substantial discretion, especially where they may consider pain and suffering, to assign high values to life. Juries in such cases will be determining damages only after a finding of liability, of wrongdoing by a defendant. It is conceivable that, faced with a negligent or otherwise blameworthy actor, juries will tend towards overcompensation as a punitive measure.

In addition, juries are not repeat players; they look only at the effects of a particular case. Each jury that considers damages may fail to consider the cumulative effects of overcompensation in the aggregate of cases. Thus, total or average jury awards are likely to represent an example of the "tragedy of the commons" phenomenon in which individual action -- while relatively harmless in isolation -- can accumulate to produce major social dislocations.

Interestingly, while these biases suggest that jury verdicts will produce ex post life valuations that are "too high," existing research indicates that verdicts are uniformly below the generally accepted willingness-to-pay figures. Machol states:

> All such methods come out with values under one million dollars per life. In the case of settlements by insurance companies in major aircraft accidents, the average 10 years ago was under $200,000 and is now several times as large, though still less than one million dollars.[128]

Viscusi reports that: "The average bodily injury payment for fatalities in product liability cases is about $212,000 (1982 dollars) . . . ."[129] Finally, Miller found that "the average jury award for wrongful death . . . has risen to about $1,000,000."[130] Nevertheless, Miller believes that as the willingness-to-pay approach becomes more firmly established in the regulatory area, it will have the indirect effect of driving up jury awards in wrongful death cases, substantially narrowing currently observable valuation discrepancies.[131]

Values derived for wrongful death purposes are not frequently utilized now in regulatory settings, but they nevertheless continue to attract some regulatory attention. In its current guide (issued in 1981) for valuing life, the Federal Aviation Administration noted approvingly that, while the FAA valuation methodology is not a human capital one, the value it yields "approximates the average 1979 judicial settlement of $503,000, after making an allowance for inflation."[132] Moreover, vestiges of human capital reasoning linger on in some regulatory areas, mainly at the National Highway Traffic Safety Administration according to Miller.[133] But on the whole, human capital valuation in regulatory situations has lost whatever adherents, e.g., OSHA, it formerly had

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[127] EPA, supra note 7, at 5-2. Much the same point is made in OMB, supra note 5, at xix-xxii.

[128] Machol, How Much Safety?, 16 Interfaces 4 (Nov./Dec. 1986).

[129] Viscusi, in Bentkover at 202.

[130] Miller, supra note 82, at 5 as well as Federal Highway Administration, Alternative Approaches to Accident Cost Concepts: State of the Art.

[131] Id.

A final point reinforces the argument implicit in what we have said to this point concerning vicissitudes in human life valuation in different contexts. Even from an ex ante perspective, lives may carry different values depending on whether we are talking about certain death for a given number of unknown persons or a risk of death for a larger group of persons, so that the expected deaths in the two groups are equal. Assume, for instance, that we must decide which of two strategies to follow. One will avoid certain death to a single, unidentified individual in a population of 100,000. The other will reduce to zero a risk that otherwise would cause to each individual in the same population a 1 in 100,000 risk of death. If the two strategies cost the same, is there reason to favor one over the other? In a survey based on these alternatives, Jones-Lee, Hammerton, & Philips found that respondents did care about which alternative was selected, with a mild preference for avoiding the certain, but anonymous, death over the purely statistical one.[134] Nevertheless, such preferences will not be reflected in willingness-to-pay studies that draw on contexts that fail to distinguish among the various situations in which valuations of life are required.

These criticisms of the willingness-to-pay approach strongly suggest that the methodology is inappropriate for defining an exact figure that represents the value of human life. Failure to accomplish that objective, however, does not necessarily render willingness-to-pay studies irrelevant to agency determinations of regulatory impact. If incorporation of soft variables and externalities and correction of informational and cognitive errors did not produce figures for the valuation of human life several magnitudes greater than the flawed processes currently used, then it is unclear that existing distortions would make substantial difference in many cases. For instance, if imperfect willingness-to-pay studies support a human life valuation of approximately $5 million,[135] then even a perfectly performed valuation (assuming such a method could be designed) may not justify implementation of a regulation that cost $50 million per life saved if the corrections incorporated in the study did not justify a tenfold increase in the value of human life. Our critique of willingness-to-pay, therefore, should be understood less as an appeal to ignore these studies than as a warning to understand their limitations. Acceptance of findings from these studies should be viewed most skeptically where they produce dollar values close to the cost per life of proposed regulations, for it is in those situations that failure to consider all relevant variables will have the greatest impact on ultimate result.

IV. Discounting -- A Hybrid Philosophical and Economic Issue

1. Introduction.

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[132] FAA, Economic Values for Evaluation of FAA Investment and Regulatory Programs 27.

[133] Miller, supra note 82, at Table 1.

[134] See Jones-Lee, Hammerton, & Philips, supra note 100, at 64.

[135] See Moore & Vicusi, supra note 124.

The decision to regulate a suspected health or safety hazard represents a judgment that some mandated change in behavior or circumstance will lessen the risk of illness or accident. The decreased risk constitutes a social benefit, valuation of which constitutes the central concern of this report. The mandated change typically imposes burdens on those required to comply with the regulation. (If it did not, i.e., if the benefits of the risk reducing measures could be captured -- through market measures or otherwise -- by those required to take them, presumably risk reduction would occur voluntarily.) These benefits and burdens, however, may occupy very different temporal frames. The benefits of regulation often will not be realized until a substantial period of time after their costs have been incurred. This is particularly the case where benefits take the form of avoiding injuries or illnesses characterized by long latency periods. For instance, in reviewing a proposed rulemaking concerning coke ovens, OMB assumed that cancers would typically not materialize for seven years after the exposure that would be avoided through regulation. If one defines the "injury" that regulation addresses as the manifestation of the cancer rather than the initial exposure, there is a significant temporal gap between the period in which the costs necessary to avoid the exposure are incurred and the point at which benefits of injury avoidance materialize. In cases of substantial latency periods, e.g., storage of nuclear waste where current regulations may prevent harms from materializing in 10,000 years,[136] the benefits of current regulations may be conferred on those who have little relationship to the individuals who incur the attendant costs.

This temporal disparity of costs and benefits raises issues of both philosophical and economic importance. These issues center on the use of "discounting" to enhance the comparability of regulatory options.[137] Discounting attempts to factor into any regulatory analysis the assumption that dollars invested in regulation presumably would otherwise have been invested in productive ventures with a positive rate of return. Thus, during the period between imposition of costs and realization of benefits, the dollars invested in regulation bear an opportunity cost equal to the productive value they would have generated through an alternative investment. As an economic matter, any comparison of the costs and benefits of a particular regulation should place these effects on a common basis by referring to their values at the same point in time. Discounting accomplishes that task by reducing the expected benefits to their present value or increasing the value of current costs to the period when benefits will be realized.

A simple example may illustrate the point. Adoption of one regulatory alternative may impose $10 million in compliance costs this year and none thereafter, while a second imposes $5 million this year and $5.5 million in two years. If both yield much the same payoff in social benefits (e.g., either measure would prevent 10 deaths in 10 years), how do we decide between the two? To say that the second alternative is $500,000 more costly ignores the fact that deferral lightens any burden, because interest can be earned until the cost is imposed. Discounting provides a sounder basis for comparison, as it takes into account the forgone earnings that the first alternative entails. We need "only" know the applicable interest rate to complete the analysis.

Obviously, discounting can have substantial impact on the relative merits of proposed regulation. For instance, in the coke oven example cited above, OMB estimated that the proposed regulations would cost approximately $2.2 million per life saved. These savings, however, would not be realized, under OMB calculations, for approximately seven years. Assuming an interest rate of 10%, the value of a current expenditure of $2.2 million per life doubles to $4.4 million over that seven year period. Thus, if one were to assume that a statistical life were worth approximately $2 million, the regulation might appear reasonable under a regime that compared undiscounted costs and benefits, but not once discounting entered the picture.

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[136] See Murauskas & Shelly, Local Political Responses to Nuclear Waste Disposal, Cities 157 (May 1986).

[137] We use "discounting" to refer to two distinct but related economic phenomena. Strictly speaking, "discounting" refers to the question of the present value of benefits that will not be received until some point in the future. Our discussion also involves "compounding," which refers to the question of the value in the future of a benefit received at present.

Alternatively, one may reduce (discount) future benefits to their present value to equate temporally costs and benefits. Thus, if a life worth $2 million will only be saved seven years hence, its discounted value today (again assuming a 10% interest rate) will be worth only about $1 million. Thus, a regulation that requires current expenditures in excess of $1 million per expected life saved would not be worth implementing on a pure cost effectiveness rationale. While this procedure may crudely be referred to as "discounting lives," it may more euphemistically be considered a comparison of the benefits of regulation with the benefits forgone by not investing the same dollars in some alternative enterprise. As a matter of economics, consideration of these opportunities is appropriate, as they constitute a loss of welfare from rendering the benefits of an investment unavailable for immediate consumption or reinvestment.[138]

Behind the logical force of discounting, however, lurks a semantic distinction that calls the propriety of the enterprise into question. We have to this point interpreted the assumed benefits of regulation as the avoidance of injury or illness that would otherwise materialize with a stated level of probability. It is the existence of a latency period between exposure to a hazard that generates the injury or disease and the onset of that adverse effect that requires attention to intertemporal costs and benefits. While the latency period properly measures the time between exposure and onset, however, avoidance of the injury at the end of that period does not necessarily constitute the salient benefit of regulation. Instead, one may consider regulation beneficial insofar as it reduces or totally avoids the risk that the injury or illness will materialize. *That* effect (risk reduction) arguably materializes as early as the time when the costs of regulation are incurred. In some cases, costs will be extended over a substantial period of time and risk reduction will not materialize until substantial investments have been made. Incremental cleaning of a heavily polluted water supply may be an example of such a phenomenon. Alternatively, risk reduction may be attained only through investment in a step good, so that no reduction occurs until a substantial investment has been made over a period of time. In such cases, the discounting issue remains, as there is still a temporal disparity between incurring costs and obtaining the benefits of risk reduction. Nevertheless, risk reduction may materialize before the latency period expires. Then the effect of discounting for any given discount rate will be less significant than if the discounted benefit were defined solely as the avoidance of the injury at the end of the latency period. In other cases, incurrence of costs and risk reduction will be simultaneous, e.g., the removal of asbestos insulation from a building. In such a case, defining risk reduction as the regulatory benefit effectively eliminates the need for discounting. At the very least, the risk reduction period eliminates certain costs, such as those related to anxiety otherwise produced in an exposed population concerning whether they will ultimately contract the feared disease.[139]

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[138] See Baumol, On the Social Rate of Discount, 58 Am. Econ. Rev. 788 (1968).

[139] For cases dealing with liability for anxiety within an exposed population about contracting subsequent disease or injury, see Hagerty v. L & L Marine Services, Inc., 788 F.2d 315 (5th Cir. 1986); Sterling v. Velsicol Chemical Corp., 647 F. Supp. 303 (W.D. Tenn. 1986); Eagle-Picher Industries, Inc. v. Cox, 481 So. 2d 517 (Fla. App. 1985); Payton v. Abbott Labs, 386 Mass. 540, 437 N.E.2d 171 (1982).

There is substantial logic in using the risk-reduction period rather than the end of the latency period (the time between exposure and manifestation of injury) as the benchmark of benefit. Assume, for instance, that a carcinogenic agent were removed from an environment in which it presented a .001 probability of causing cancer. But for removal of the agent, it would have been most unlikely that an individual exposed to that environment would contract cancer. Nevertheless, we would not say that the individual received no benefit from the removal. Instead, we would say that the individual benefited from elimination of a .001 chance of contracting cancer. But if that is the case, then that benefit materialized not at the end of the latency period for the carcinogen, but at the time when the risk was removed, i.e., when the costs of removal were incurred. Since the costs and benefits occurred simultaneously, there is no need to discount.

Nevertheless, exclusive focus on the risk-reduction period could lead to questionable, if not perverse, results. Assume, for instance, that we could spend $x on either of two programs. Program A would immediately remove a risk expected to cause the deaths of 100 people in 5 years. Program B would immediately remove a risk expected to cause the deaths of 100 people in 20 years. Our intuition is that most people would prefer to spend the available funds on Program A. Perhaps this conclusion would be justified because more of the people who would be saved by implementing Program B can be expected to die of other causes during the latency period. Alternatively, saving lives sooner might be viewed as a benefit insofar as it permits quicker growth of the population (on the questionable assumption that having more people sooner is a benefit). If our intution is correct, however, then the objective that it seeks to attain can be reached only by focusing on the latency periods of the harms avoided by the two Programs. Focus on the risk reduction period alone leads one to be indifferent between the two Programs as they immediately reduce the same quantity of risk. The only way to use risk reduction as a benchmark in this example and still reach the intuitively correct result is to consider the time period when lives will be saved when comparing the costs of risk reduction to their benefit. That inquiry, however, reintroduces the discounting quagmire through the back door.

Notwithstanding the complexity of these arguments, current federal government practice is to discount benefits from the end of the latency period. In the remainder of this section, therefore, we will evaluate the arguments and methodology concerning discounting. In our discussion, we will refer to the time between exposure to a risk and onset of the related illness or injury as a latency period and to the gap between incurring the costs of risk reduction and materialization of risk reduction as the pre-reduction period.

2. The Arguments Against Discounting.

Notwithstanding the economic logic of discounting, the procedure has met with considerable philosophical debate. To some extent, the temporal divergence of those who benefit from injury avoidance and those who pay for it suggest that discounting may be necessary to reduce intergenerational inequities. As latency periods and pre-reduction periods increase, the question of discounting raises the issue of the extent to which we owe obligations to future generations. Should full costs of injury avoidance be incurred by the present generation while benefits are realized only in the future, those future individuals who benefit from current investment in safety will bear none of the commensurate burden. Simultaneously, injury avoidance costs borne by the present generation will constitute forgone opportunities for current consumption or alternative investment that might provide a very different temporal mix of benefits and burdens.

For the most part, however, the philosophical debate reflects a different view of intergenerational justice. For instance, some commentators contend that since the question of when one exists is purely a matter of fortuity, discounting benefits to justify current consumption at the expense of future generations accords to the latter an insufficient level of respect.[140] Implicit in this view is the (debatable) view that future generations will share the preferences of the current generation. Thus, it is anticipated that they will value the same amenities of life that are currently cherished. Should preferences change in some unexpected way, we would be faced with the extraordinary difficulty of predicting future concerns and comparing the worth of intertemporal preferences.[141] If preferences adapt to what is currently available (a "sour grapes" approach to amenities), then it is likely that future scarcity imposed by curent consumption will not necessarily adversely affect the enjoyment of future generations. Assume, for instance, that future generations value wilderness areas less highly than the current generation does. If that change were to materialize, future generations would look askance at current decisions to forgo technological advances in order to preserve natural settings for posterity.[142]

Putting to one side the difficulties of changed preferences, discounting raises serious issues of the relative importance of succeeding generations. Derek Parfit has argued, for instance, that applying a social discount rate of x percent per year tends to ignore future events as "morally trivial," at least in the situation where decision makers literally "discount lives" by finding that a number of future lives is equivalent to a smaller number of present lives.[143] Parfit postulates a scenario in which nuclear waste causes one billion deaths in 500 years. At a discount rate of only 5%, those deaths are equivalent to a single death today. Thus, if we would not be willing to expend the resources necessary to avoid one death today, discounting suggests that we should be similarly unwilling to spend that sum, even though the benefit would instead be the certain saving of one billion deaths in 500 years. For Parfit, discounting in this manner suggests that the moral significance of these future deaths has declined, a conclusion he deems unjustifiable.

Parfit concludes that the opportunity cost explanation for discounting does not justify the use of the procedure. He posits a case in which benefits would be consumed, rather than reinvested, e.g., the natural beauty of the countryside that would be destroyed by construction of a proposed airport.[144] In Parfit's view, future generations do not receive any increased value from a reinvestment of the current generation's appreciation of the countryside. Thus, the future's enjoyment of the view cannot be discounted to reflect any present value.

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[140] The debate about this attitude is evidenced in a dialogue between a geologist who wishes to mine in the Cascade Mountains and a conservationist who wishes to preserve them, as recounted in J. McPhee, Encounters with the Archdruid: Narratives About a Conservationist and Three of His Natural Enemies 74 (1971):

> "The future can take care of itself," Park said. "I don't condone waste, but I am not willing to penalize present people. I say they're penalized if they don't have enough copper. Dave says they're penalized if they don't have enough wilderness."

Implicit in this statement is the important lesson that all courses of action impose costs. The issue then, is not cost avoidance, but cost optimization.

[141] See Golding, Obligations to Future Generations, 56 Monist 97 (1972). But see Kavka, The Futurity Problem, in R. Sikora & B. Barry, Obligations to Future Generations 186, 189-92 (1978).

[142] See e.g., Krieger, What's Wrong with Plastic Trees?, 179 Science 446 (1973).

[143] See D. Parfit, supra note 115, at 357.

[144] Id. at 483.

This is not to say that Parfit believes that future benefits must always be weighed against current costs as if the two were contemporaneous. Instead, he argues that:

> conclusions that are established by such (opportunity cost) calculations could be re-expressed in a temporally neutral way. When describing the effects of future policies, economists could state what future benefits and costs there would be, at different times, in a way that used no discount rate. The arguments that appeal to opportunity costs could be stated in those terms.[145]

Parfit's suggestion is somewhat confusing. It is unclear whether he is permitting decision makers to consider at all the issue of when the costs and benefits of a policy will materialize. Further, his conception of a "temporally neutral" decision ignores the fact that while discounting favors present benefits over future ones, failure to discount does just the opposite. "Neutrality" in this situation seems rather fictitious. At a minimum, however, Parfit seems concerned that formal calculations of a discount rate and current valuations of future benefits will interfere with, rather than assist, intuitive judgments concerning alternative policies. Even here, though, intuitions are not unidirectional. Substantial writing suggests that we have obligations to those with whom we are in a special relationship that exceeds our obligations to strangers.[146] As a legal matter, some special relationships trigger obligations not present to the public at large.[147] The temporal extension of this view would hold that we have obligations to those who currently exist that do not necessarily extend to those yet to be born.

In a vein similar to Parfit, Peter Railton has argued that discounting produces perverse effects insofar as it favors policies that produce short-term benefits while imposing long-term costs.[148] Railton's argument is a direct attack on those who, apart from discounting, contend that it is sensible to impose costs, e.g., environmental harms, on future generations because they are likely to possess technological advances necessary to bearing those costs. Railton argues instead that caution is appropriate when considering future effects -- particularly in the environmental area -- because "(i)t is . . . almost always easier to do than to undo ecological damage."

Railton attempts to demonstrate the perversity of discounting by postulating two policies, A and B. The former will save 8 "present" lives while causing 12 "surplus" deaths in 15 years. The latter has only future effects: it will save the lives of 14, and cause the death of 12, both in 15 years. Railton suggests that discounting would favor the former policy, notwithstanding that it causes more "actual" deaths than it saves, because (assuming a discount rate in which money doubles every 15 years) the 8 current lives have a dollar equivalent of 16 lives when the costs materialize. (Railton's argument is couched largely in terms of the propriety of monetizing human life, an approach that he implies necessarily entails some use of human capital evaluations. As we find that approach inappropriate, but unnecessary, we couch his argument in more generic terms of numbers of lives). He seconds Parfit's view that discounting provides little basis for deferring adverse effects that have no economic value and, thus, cannot appreciate: "the gain in happiness to a family that does not lose a beloved member in, say 1987, will not compound at a social rate of interest to become an amount of well-being large enough to offset the bereavement of two families, each of whom loses a beloved member in 2002."[149]

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[145] Id. at 484.

[146] See Anderson, Values, Risks, and Market Norms, 17 Phil. & Pub. Aff. 54, 58 (1988): Fried, supra note 71.

[147] See, e.g., Tarasoff v. Regents of University of California, 17 Cal.3d 425, 551 P.2d 334, 131 Cal. Rptr. 14 (1976).

[148] See Railton, The Search for a Single Metric (unpublished manuscript 1987).

The lesson learned from this critique is not that discounting is always inappropriate. Both Parfit and Railton suggest that discounting may be useful, as when there exist predictable technological improvements that will render future generations better able to deal with costs while still enjoying benefits conferred by the present. Rather, the appeal of the critique lies in its implicit rejection of a unitary conception of societal assets. Some assets increase in value over time and are thus susceptible to discounting. Others, however, may be so idiosyncratic, irreplaceable, or external to market transactions that they are less vulnerable to the arguments (compounding interest and opportunity costs) that underlie discounting. The important regulatory implication, therefore, is that a uniform approach to the issue of discounting may not be suitable; some analysis will first be needed of the types of future costs and benefits and their susceptibility to intertemporal comparisons.

3. OMB Discounting Guidance and Agency Practice.

In 1972, the Office of Management and Budget issued Circular No. A-94 to establish a common discount rate for use throughout government, except where statutes prescribed alternative rates. OMB selected a rate of 10%, which remains unchanged, as "an estimate of the average rate of return on private investment, before taxes and after inflation".[150]

While much discussion has ensued over the years about the suitability of this rate, a topic we take up in the next section, OMB has continued to urge use of the 10% rate in agency analyses of both the costs and benefits of regulations, as well as of other agency programs. However, since 1981, OMB has taken the position that any agency should feel free to supplement use of the 10% rate with analysis showing the sensitivity of the outcomes to selection of any other rates the agency thinks applicable.[151]

Moreover, in the 1987-88 edition of the Regulatory Program of the United States,[152] OMB's discussion of discounting practices and objectives calls attention in non-judgmental fashion to cases in which agencies have relied on rates other than 10%, and OMB is silent on whether use of that figure continues to be desirable. Indeed, in our discussions OMB staff indicated that, in light of work done by Lind and others, 10% is not always the best choice.

Whatever the particular discount rate selected, OMB has argued consistently that the same rate should be applied to benefits and to costs. This normally involves computing the present values of each (although OMB points out that alternatively agencies can annualize the benefit and cost streams over the same time frame).[153] Nonetheless, agencies not infrequently depart from this practice, declining to apply discounting to future benefits at all, or using a lower discount rate for benefits.

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[149] Id. at 37.

[150] Circular No. A-94 at 4.

[151] See OMB's Interim Regulatory Impact Analysis Guidance.

[152] See OMB, supra note 5, at xxi.

[153] Id. at xxii.

The Regulatory Program cites two OSHA rulemakings (for asbestos and ethylene oxide) where the agency applied a 10% discount rate to costs but did not discount benefits at all, and another EPA rulemaking (for lead phasedown) where discounting occurred at a three percent rate.[154] By contrast, EPA, in its December 1986 analysis of drinking water lead risks, used a five percent discount rate for benefits from reducing lead in drinking water, while adhering to the 10% rate for costs.[155] At NHTSA, the preferred discount rate is seven percent,[156] although its parent Department of Transportation suggests that all parts of the department should be complying with the OMB prescribed rate.[157] Actual discounting practices are indeed diverse.

4. Choosing the Discount Rate.

As noted in earlier sections, discounting may not always be suitable in evaluating fatality reduction benefits. But where discounting is desirable, the question remains of how best to choose the rate. Little agreement exists about the proper number or even about the correct methodology for finding the number. Under these circumstances, sensitivity analysis is particularly inviting. The idea is to show how much the results would differ by switching to alternative discount rates. Then, if the regulation looks appealing for a range of discount rates, it matters little which rate is optimal, and the discount rate choice can be side-stepped.

One obvious starting point for discount rate choice is OMB's current guidance. As noted above, OMB based its choice on the rate of return available on private investment. The logic is that a government project (or mandated expenditure for regulatory compliance) draws funds away from private investment projects, depriving society of the related productive activity. The pre-tax rate of return then is relevant, because society also experiences a loss of tax revenues if the capital investment is not made. Thus the discount rate is chosen to reflect the real opportunity cost of capital, and as such a 10% rate is not unreasonable. Indeed, some have suggested a rate anywhere in the range of 10 to 25% could be justified.[158]

However, the costs of regulation may take various forms, forgone capital investment being only one. In particular, the costs may show up as reduced consumption (through higher consumer product prices). Then a different conceptual framework is needed, and much work has been done in recent years to develop a suitable one.[159] To the extent that the compliance cost takes the form of reduced consumption, the regulation should be evaluated in terms of how people value a loss of present consumption. This we can accomplish by identifying the interest rate level high enough to induce people to postpone consumption, i.e., to save. While one can debate the precise number for this interest rate, often termed the "social rate of time preference," certainly the range is considerably lower than that for capital rates of return.[160]

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[154] Id. at xvii.

[155] EPA, Reducing Lead in Drinking Water: A Benefit Analysis, III-58, IV-49.

[156] The Economic Cost to Society of Motor Vehicle Accidents at V-4.

[157] See DOT, Guidance for Regulatory Evaluations: A Handbook for DOT Benefit-Cost Analysis at 17.

[158] R. Tresch, Public Finance: A Normative Theory (1981).

[159] See Bradford, Constraints on Government Investment Opportunities and the Choice of the Discount Rate, Am. Econ. Rev. 887 (1975); Lind, Discounting for Time and Risk in Energy Policy (1982).

[160] Tresch puts the range at 3 to 6 percent for the social rate.

The most promising discounting framework now appears to be one which in essence combines these two approaches, recognizing that both investment and consumption may decline near-term when regulation is imposed. The intent is to identify the portion of compliance cost that does displace private investment and then to translate that displacement into a corresponding forgone future stream of consumption -- consumption that will not take place because the capital investment necessary to generate it never took place. These "consumption-equivalent" costs of the regulation then can be added to the compliance costs that do not come at the expense of investment (that is, costs born by consumers right from the start). All costs thus can be portrayed as lost consumption, some now and some later. The final step then is to utilize the social rate of time preference as the discount rate in computing the present value of this stream of future effects.[161]

This falls short of providing a firm answer to the question of "What number?," in part because the most satisfactory approach conceptually (the framework just discussed) is not easy to apply empirically. But most would agree that 10% is too high a rate.

IV. Recommendations

The foregoing discussion leads us to recommend a series of measures for agency regulations that affect human life. Our recommendations are predicated on the belief that the uncertainties underlying valuations of human life provide agencies with substantial discretion in justifying decisions to implement or reject proposed regulations based on factors only tangentially related to the relative benefits that would be conferred through regulation. We are not suggesting that agencies have failed to adopt more precise measures that would improve the quality of their life valuations. To the contrary, we recognize that given the embryonic state of knowledge on this issue, both methodologies and results are likely to vary across agencies. Additionally, we are sensitive to arguments that lives should be valued differently in different contexts. In this environment, however, we believe it would be useful for agencies to take measures that would reveal publicly the processes through which they have determined the valuation of life incorporated in policy decisions. In this way, agency practice can be measured against developments in the valuation area and evaluated for consistency with other agencies and other regulations in the same agency. Most importantly, full disclosure of agency practices provides the best way to hold agencies accountable for selecting a particular set of variables for consideration and excluding others. Toward these ends, we recommend the following procedures.

1. Agencies that adopt regulations substantially on the justification that reduction of risk to human lives warrants incurring the associated implementation and compliance costs should state an explicit valuation utilized, or should disclose the cost per statistical life saved implicit in that determination. Such a procedure will provide useful clarification and exposition of the unavoidable tradeoffs involved in regulating hazards and assist in drawing attention to those hazards where further protection may be feasible at acceptable cost. This is not to say that decisions about relative costs and benefits of a proposed regulation cannot be trumped by other variables. We believe, however, that the explicit values used by an agency is a relevant datum to be used by political decision makers in determining whether to employ those trumps. Exceptions to this principle might exist where empirical information about either the regulation's costs or benefits is highly conjectural or where the

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[161] Fuller discussions of this approach appear in Lind, supra note 149; Staiger & Richardson, A Discounting Framework for Regulatory Impact Analysis, 18 Policy Sciences 33; EPA, Guidelines for Performing Regulatory Impact Analysis, Appendix C.That the same rate should be applied to benefits as to costs is discussed in DOT, 1 Methods for Economic Assessment of Transportation Industry Regulations III-17.

benefits include a variety of non-market improvements where monetizable benefits are not obvious, e.g., aesthetic gains. In such cases, efforts to characterize accurately the imprecision of the valuation process may minimize the perception of substantial certainty.

2. We believe that continued use of willingness-to-pay methodology to place value on human life requires more attention to the limitations of that approach. While willingness-to-pay provides the most inclusive analysis currently available for evaluating the benefits derived from regulatory reduction of fatalities, it falls far short of an ideal process and can produce results that are misleading for failure to consider all variables relevant to an inclusive valuation process. While current willingness-to-pay investigations incorporate factors not considered in alternative methodologies, they cannot satisfactorily account for informational disabilities or cognitive error in the respondent population. We recommend, therefore, that any valuation of life, whether based on willingness-to-pay or an alternative methodology, be accompanied by a statement of variables that the agency believes to have been slighted or omitted from consideration but that would affect (positively or negatively) the explicit values derived. The agency should also explain how it takes account of any such additional factors.

3. OMB'S Circular A-94 concerning the use of a discount rate should be revised to reflect learning on the subject since the time of its promulgation. We do not endorse the adoption of a specific discount rate. Rather, we recommend that a revised Circular articulate the various methods by which a discount rate can be derived and the scope of subjects to which it can be applied. However agencies choose to discount costs and benefits, they should clearly and fully disclose what rates they are using, the methodology that generated those rates, and the sensitivity of outcomes to the particular rates applied.

4. While uniform practices in the life valuation area may not be warranted (because of the diversity of hazard situations, as well as the inconclusive nature of much of the empirical information on which decisions are based) there is justification for greater interchange of information among agencies on how decisions are made and utilized in this contentious area. Thus, we recommend the creation of a central clearing house for research on valuation issues. To this end, we suggest that OMB expand its discussion of agency practices, initiated in the 1987-88 volume of the annual Regulatory Program and make such discussion a standard practice.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-8

LIFE IN THE ADMINISTRATIVE TRACK:

ADMINISTRATIVE ADJUDICATION OF CLAIMS AGAINST SAVINGS INSTITUTION RECEIVERSHIPS

by

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LIFE IN THE ADMINISTRATIVE TRACK: ADMINISTRATIVE ADJUDICATION OF CLAIMS AGAINST SAVINGS INSTITUTION RECEIVERSHIPS

LAWRENCE G. BAXTER[*]

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INTRODUCTION

In the modern financial services industry, thrifts[1] engage in an unprecedented range of complex and risky commercial transactions. Consequently, the receiver of a failed thrift, which in most cases is the Federal Savings and Loan Insurance Corporation (FSLIC) appointed by the Federal Home Loan Bank Board (FHLBB),[2] is likely to face a host of complex claims. These claims arise not only from the thrift's deposit liabilities but also from its investment transactions and the incidental disputes generated by such activities. The scene of a thrift failure is often already strewn with litigation, and the receivership itself is likely to generate still more.[3] Even if litigation has not yet commenced, the receiver has to pay the thrift's valid credit obligations and so has to distinguish good claims from bad and quantify the former. In the process of accepting, settling or rejecting a diverse and complex range of creditor claims, disputes concerning their validity will have to be resolved informally or, if this cannot be done, either through the judicial process or by administrative adjudication. The latter process is the subject of this study.

The importance of this claims determination process has grown with the escalation of thrift failures in recent years.[4] Although, with the assistance of the FSLIC, many insolvent thrifts can be restored to financial health, sold or merged, a significant number have already proven so irretrievable that the FHLBB has had to place them into liquidation. As of July 1, 1988, the FSLIC was administering 84 liquidating receiverships involving $8.2 billion in receivership assets and considerably more in uninsured creditor claims.[5] Insofar as they help to avoid litigation, the claims determination procedures employed by the receiver are very important in expediting and reducing the cost of thrift liquidations. On the other hand, these procedures have to satisfy conflicting considerations. They must be capable of processing claims efficiently and resolving disputes between creditors and receivers. They should also remain fair to both parties and they must, of course, rest upon a sound legal foundation.

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[1] "Thrift" is used throughout this article to refer to federally chartered and state-chartered, federally insured building associations, savings and loan associations and savings banks. *See infra* notes 26-39 and accompanying text.

[2] For a general discussion of the power to appoint receivers, see *infra* notes 165-75 and accompanying text.

[3] *See infra* notes 228-43 and accompanying text.

[4] *See infra* notes 77-87 and accompanying text.

The FHLBB and the FSLIC have asserted exclusive jurisdiction to adjudicate claims against thrift receiverships. These agencies argue that their claims determinations are subject not to independent, de novo judicial determination, but only to the limited judicial review provided under the federal Administrative Procedure Act (APA).[6] This view has become known as the "*Hudspeth* doctrine," after the Fifth Circuit decision in which it was first accepted.[7] Yet, because of the enormous adjudicatory power that the *Hudspeth* doctrine concedes to these agencies, the doctrine has provoked controversy concerning the quality, fairness and efficacy, as well as the legal and constitutional validity, of the agencies' procedures. Although *Hudspeth* has been reaffirmed many times by the Fifth Circuit, and has attracted a large following in the district courts and some state courts,[8] the Ninth Circuit has refused to follow it, holding that the FSLIC has no statutory authority to adjudicate claims to the preclusion of the courts.[9] The Texas Supreme Court has taken the same view in affirming the decision of a state court of appeals that had ruled that the FSLIC has indeed been granted adjudicative authority by statute but that this authority is unconstitutional.[10] The plethora of conflicting decisions has produced an unusual situation in which two circuits—the Fifth and the Ninth—are in direct conflict,[11] a third—the Seventh—is somewhat equivocal,[12] state courts within the territorial jurisdiction of the Fifth Circuit have either followed the ruling of the Ninth Circuit[13] or gone even further,[14] and state courts within the territorial jurisdiction of the Ninth Circuit have followed the Fifth Circuit,[15] while district courts within the territorial jurisdiction of the Seventh Circuit have gone in opposite directions.[16]

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[5] Telephone interview with Judith L. Friedman, Associate General Counsel, FHLBB (Aug. 29, 1988). As of December 31, 1986 (the most recent date for which figures are available), creditor claims already exceeded $8 billion. 1986 FHLBB ANN. REP. 27-35 (1987).

[6] 5 U.S.C. § 706 (1982) (scope of judicial review for agency action); *see infra* text accompanying notes 498-509.

[7] North Miss. Sav. & Loan Ass'n v. Hudspeth, 756 F.2d 1096 (5th Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986). For a discussion of *Hudspeth*, see *infra* notes 98-117 and accompanying text.

[8] *See infra* notes 118-20 and accompanying text.

[9] *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1212 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); *see infra* notes 124-31 and accompanying text.

[10] *See* FSLIC v. Glen Ridge I Condominiums, Ltd., 750 S.W.2d 757, 759 (Tex. 1988) (per curiam), *aff'g* 734 S.W.2d 374 (Tex. Ct. App. 1986) (discussed *infra* at notes 135-40 and accompanying text).

This riotous state of affairs will be partly resolved this Term by the Supreme Court. Of four petitions for certiorari that have now been filed, the Court has chosen to hear the one—*Coit Independence Joint Venture v. FirstSouth, F.A.*[17]—that is couched in the broadest terms;[18] the out-

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[11] *See supra* notes 7-9 and accompanying text.

[12] *See* Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 828 F.2d 387 (7th Cir. 1987) (discussed *infra* at note 134). The decision in *Lyons* elicited a comment from District Judge Roszkowski that the Seventh Circuit is "never one to rush in where angels fear to tread." Homestead Sav. v. Life Sav. & Loan Ass'n, 668 F. Supp. 1121, 1124 (N.D. Ill. 1987) (opinion vacated and removed from bound volume, but appears in West's advance sheets, *see infra* notes 738-39 and accompanying text).

[13] *See Glen Ridge I,* 750 S.W.2d at 759; Summertree Venture III v. FSLIC, 742 S.W.2d 446, 453 (Tex. Ct. App. 1987).

[14] *See* Glen Ridge I Condominiums, Ltd. v. FSLIC, 734 S.W.2d 374, 386 (Tex. Ct. App. 1986) (holding statutory grant of adjudicative authority to FSLIC unconstitutional), *aff'd on other grounds,* 750 S.W.2d 757 (Tex. 1988) (per curiam); *supra* note 10 and accompanying text.

[15] *See* Modern Supply Co. v. FSLIC, 50 Wash. App. 194, 748 P.2d 251 (1987) (split decision); FSLIC v. Superior Court, 180 Cal. App. 3d 336, 225 Cal. Rptr. 422 (1986).

[16] *See Homestead Sav.,* 668 F. Supp. at 1121. *Contra* Rigali v. Life Sav. & Loan Ass'n of Am., No. 87-C-2543 (N.D. Ill. June 16, 1987) (Westlaw, 1987 WL 12677).

[17] 829 F.2d 563 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988).

[18] The questions presented place in issue (i) the statutory authority of the FSLIC as receiver to adjudicate state-law causes of action asserted against failed thrifts; (ii) the acceptability of such a scheme under article III of the Constitution; (iii) the compatibility of such a scheme with the due process clause; and (iv) whether the scheme violates the seventh amendment right to a jury trial. *See* Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit at i, Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1987) (No. 87-996).

A number of briefs have been filed in the *Coit* appeal. For those supporting the petitioner, see Brief for Petitioner; Petitioner's Reply Brief; Brief Amicus Curiae of Joseph M. Hudspeth in Support of Petitioner; Brief of Amicus Curiae United States League of Savings Institutions in Support of Petitioner; Brief Amicus Curiae of George S. Watson, A. Starke Taylor III and Watson & Taylor Realty Company in Support of Petitioner. For those supporting the FHLBB and the FSLIC, see Brief for the Respondent; Motion of the Federal Home Loan Bank of Dallas, Federal Home Loan Bank of San Francisco, and Federal Home Loan Bank of Topeka for leave to file Brief as Amici Curiae and Brief as Amici Curiae Supporting Affirmance; Brief of Amicus Curiae National Council of Savings Institutions in Support of Respondent. It is interesting to note the opposition of the two major thrift lobbies. Most surprising is the respondent's brief filed by the Solicitor General: notwithstanding the favorable holding in *Hudspeth,* the position consistently maintained by the FSLIC in subsequent litigation, and the FHLBB's publication of rules establishing an adjudicative process, the respondent's brief disavows any statutory authority on the part of the FSLIC to "adjudicate" claims and argues only that creditors are mandatorily required to exhaust the administrative come of this case will have an automatic effect on the others.[19] Meanwhile, the pending uncertainty makes it difficult to provide a coherent administrative law evaluation of the *Hudspeth* procedures, since they might not be constitutionally valid at all.

Yet it is unlikely that the Supreme Court's decision will be entirely dispositive. Its jurisprudence in the constitutional areas traversed by *Coit Independence* has become overtly pragmatic.[20] This suggests that, even where the Court is disposed to find a particular administrative scheme unconstitutional, there might be other ways of devising a scheme that would be constitutional. The Court is unlikely to declare unequivocally that creditor claims require primary adjudication by full-fledged article III courts alone.[21] To the extent that the FHLBB's desire to avoid routine judicial resolution is dictated by severe financial and organizational constraints,[22] the Board will probably still want to devise a primary administrative adjudication scheme that is acceptable from the constitutional and administrative law points of view. *Coit Independence* can provide guidance only as to the outer constitutional constraints on any such scheme. And if, as is possible, the Court declares that the FHLBB merely lacks present statutory authority,[23] the FHLBB still has the option of seeking such authority from Congress. On the other hand, even if the Court rules that the FHLBB does have statutory authority and that this authority is constitutionally valid, many issues regarding the fairness and efficiency of the adjudicative process implemented by the Board are likely to remain in controversy. The fundamental question, then, of what would constitute a fair administrative procedure for adjudi-

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claims process before resorting to the courts. Presumably this leaves it open for claimants to assert the right to de novo review after exhaustion of their administrative remedies. The amici briefs filed in support, on the other hand, adopt more fully the position of the FHLBB and FSLIC, which denies anything other than limited, APA review in the courts.

[19] *See* FSLIC v. Bonfanti, 826 F.2d 1391 (5th Cir. 1987), *petition for cert. filed,* 56 U.S.L.W. 3165 (U.S. Aug. 5, 1987) (No. 87-255); Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); Murdock-SC Assocs. v. Beverly Hills Fed. Sav. & Loan Ass'n, 624 F. Supp. 948 (C.D. Cal. 1985), *aff'd in part and rev'd in part,* 815 F.2d 82 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Murdock-SC Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-452). The claims in the *Morrison-Knudsen* case have now been settled. *See* Brief for the Respondent at 37 n.27, *Coit Independence* (No. 87-996).

These petitions raise only the question "[w]hether claims against the assets of an insolvent, federally insured savings and loan association must be presented in the first instance in federal receivership proceedings in accordance with the Federal Home Loan Bank Board's regulations for the administrative resolution of such claims." Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit at I, *Murdock-SC Assocs.* (No. 87-452).

[20] *See infra* text accompanying notes 510-657.

[21] *See infra* text accompanying notes 545-600.

[22] *See infra* text accompanying notes 91-92.

[23] *See infra* text accompanying notes 325-429.

cating creditor claims in thrift receiverships is likely to remain important for as long as the crisis in the thrift industry persists and the present system of thrift regulation survives.[24]

This article seeks to provide some general answers to this basic question by drawing upon general constitutional and administrative law principles. Part I describes the background to the *Hudspeth* controversy by tracing the emergence and evolution of federal thrift regulation, the changing market environment, the attempts by the FHLBB to adapt to the escalation in thrift failures while coping with the rapid depletion of the federal deposit insurance fund, and the recent conflict in the courts concerning the validity of the FSLIC's assertions of adjudicatory jurisdiction. Part II describes the general receivership process and, more particularly, the *Hudspeth* process as it has now been developed by the Bank Board. Part III turns to examine the constraints by which the *Hudspeth* procedures must be judged. This involves an investigation of the statutory authority supporting the adjudicatory scheme, the applicability of the APA, and the constitutional principles that should inform the drafters of the scheme. Part IV evaluates the existing *Hudspeth* procedures according to the criteria identified in Part III, and this in turn leads to the recommendations, in the Conclusion, for clarifying the FHLBB's mandate and for improving its adjudicatory structure and claims resolution procedures.

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[24] It is, of course, conceivable that the industry might stabilize and that thrift failures might decline. If this were to happen, the FHLBB might find it more practical to rely on judicial resolution of disputed creditor claims in the few receiverships that remained.

It should also be emphasized that the entire problem might be the product of the present regulatory system. For example, it has been argued that the system of federal deposit insurance, the price of which is not risk-related, has become a major contributor to thrift (and commercial bank) failure because, in the competitive world of modern banking, it removes market disciplines. In other words, it eliminates the incentive for depositor scrutiny that would restrain industry entrepreneurs from engaging in bad-risk activities, and it transfers the costs of risk-taking from the entrepreneurs to the insurance funds and, ultimately, the general public. *See, e.g.*, E. KANE, THE GATHERING CRISIS IN FEDERAL DEPOSIT INSURANCE 7-15 (1985); Barth, Brumbaugh, Sauerhaft & Wang, *Insolvency and Risk-Taking in the Thrift Industry: Implications for the Future*, CONTEMP. POL'Y ISS., Fall 1985, at 1; Fischel, Rosenfield & Stillman, *The Regulation of Banks and Bank Holding Companies*, 73 VA. L. REV. 301, 312-18 (1987); Garten, *Banking on the Market: Relying on Depositors to Control Bank Risks*, 4 YALE J. ON REG. 129 (1986) (concluding that depositors generally are not able to control the level of their bank's risk-taking); Garten, *Still Banking on the Market: A Comment on the Failure of Market Discipline*, 5 YALE J. ON REG. 241 (1988) (same); Isaac, *The Role of Deposit Insurance in the Emerging Financial Services Industry*, 1 YALE J. ON REG. 195, 204 n.30 (1984); Macey & Garrett, *Market Discipline by Depositors: A Summary of the Theoretical and Empirical Arguments*, 5 YALE J. ON REG. 215 (1988); O'Driscoll, *Deposit Insurance in Theory and Practice*, in THE FINANCIAL SERVICES REVOLUTION 165 (C. England & T. Huertas eds. 1988); Scott & Mayer, *Risk and Regulation in Banking: Some Proposals for Federal Deposit Insurance Reform*, 23 STAN. L. REV. 857 (1971). This article assumes no fundamental reforms to the present system.

I. EMERGENCE OF THE *HUDSPETH* DOCTRINE

The present system of federal thrift regulation is the product of hastily enacted New Deal legislation that has been modified in a reactive, piecemeal fashion during the last half century. The model created by the Home Owners' Loan Act and the National Housing Act did not fully address the problem of liquidating thrifts in receivership; instead the legislators, to the extent that they thought about the problem at all, seemed concerned with the receiver's power to dispose of thrift assets rather than the method by which the validity of creditor claims should be handled. Claims determination was not directly addressed at all.[25]

To gain a full perspective, it is helpful to place the thrift industry within the broader context of the financial services industry and to describe the manner in which federal thrift regulation has evolved. We then need to examine the ways in which the thrift industry has developed since the inception of federal regulation. It is these developments that have created a need for an administrative claims settlement procedure.

A. *Thrifts and the Banking Industry.*

Liquidation procedures are not uniform throughout the banking industry, and we should take some account of the special position that thrifts occupy within banking. Thrifts are one of the three principal kinds of depository institutions, all of which are still governed by structures devised during the New Deal.[26] The other components are commercial banks and credit unions.[27] Together, thrifts—savings and loan associations and savings banks—account for approximately 20% of the private assets held by all financial intermediaries,[28] and for a little more than 35% of those held by depository institutions.[29]

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[25] *See infra* text accompanying notes 363-87.

[26] The relevant legislation for present purposes is the Home Owners' Loan Act of 1933, ch. 64, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-1470 (1982)), the National Housing Act of 1934, ch. 847, 48 Stat. 1246 (codified as amended at 12 U.S.C. §§ 1701-1750g (1982)) (governing the FHLBB and the FSLIC), the Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. §§ 1811-1832 (1982)) (governing the Federal Deposit Insurance Corporation), the Banking Act of 1935, ch. 614, 49 Stat. 684 (codified as amended at 12 U.S.C. §§ 1811-1832 (1982)) (same), and the Federal Credit Union Act of 1934, ch. 750, 48 Stat. 1216 (codified as amended at 12 U.S.C. §§ 1751-1795 (1982)) (governing the National Credit Union Administration).

[27] *See generally* 1 M. MALLOY, THE CORPORATE LAW OF BANKS § 1.2, at 4-21 (1988).

[28] *See* 2 *id.* app. at 923 chart 1.1. "Financial intermediaries" include insurance companies, real estate investment trusts, mutual, state and local government retirement funds, etc., in addition to the three sets of depository institutions. *Id.*

[29] *See id.* at 924 chart 1.2. The actual breakdown among depository institutions (as of December 31, 1983 and excluding international liabilities) was: savings and loan associations—28.7%; mutual savings banks—6.75%; commercial banks—61.0%; and credit unions—3.55%. *Id.*

Thrifts, like commercial banks and credit unions, can be chartered as state or federal institutions. Even if chartered by a state, a thrift can be federally insured.[30] Various components of the industry are regulated by different authorities. Federally chartered and federally insured, state-chartered savings and loan associations are subject to the regulatory jurisdiction of the FHLBB and the FSLIC. Federally chartered savings banks are subject to the supervision of the FHLBB and the Federal Deposit Insurance Corporation (FDIC). Commercial banks are subject to the separate regulatory jurisdiction of the Federal Reserve Board (the "Fed"), the Comptroller of the Currency (the "Comptroller"), and the FDIC. Federal credit unions are regulated by the National Credit Union Administration Board (NCUAB).[31]

Although originally formed to serve different functions,[32] savings and loan associations and savings banks have come increasingly to resemble commercial banks in their services, investment patterns, and in the conduct of their business activities.[33] Nevertheless, despite calls for the establishment of a unitary system of regulatory machinery,[34] they continue to be regulated by separate agencies and according to separate regulatory principles and procedures. This structure has facilitated the development of thrift liquidation procedures that differ from those employed by the FDIC when the latter liquidates banks. For example, except when appointed by the FHLBB as receiver of a savings bank,[35] the FDIC has not attempted to adjudicate the validity of creditor claims; instead, it relies upon judicial determination in the courts. When acting as receiver of state-chartered banks, the FDIC is also subject to the jurisdiction of the relevant local state law in its conduct of each receivership.[36]

Having once been fairly narrowly confined, the business transactions in which the thrift industry has more recently become involved have exposed thrifts to a broader range of creditor claims than was the case before 1980. The size and complexity of claims have greatly increased, simultaneously magnifying the potential for disputes concerning their validity. These developments have rendered inadequate the traditional liquidation processes employed by the FSLIC. They have created financial pressures that have induced the FHLBB and the FSLIC, in an attempt to contain the costs of liquidation, to devise new strategies for handling failed thrifts and for processing the claims of creditors administratively. At the same time, the complexity of many creditors' claims seems to have spurred attempts by creditors to litigate their claims in the courts.[37]

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[30] The overwhelming majority of thrifts are federally insured, with only Massachussetts-chartered thrifts retaining a significant level of independence from federal regulation. *See* W. LOVETT, BANKING AND FINANCIAL INSTITUTIONS LAW 237-38, 251 (2d ed. 1988) (Massachussetts state insurance system is only significant remaining state insurance system for savings banks; by 1981, savings and loan associations insured by FSLIC represented 98% of all savings and loan assets).

[31] On the structure, jurisdiction and powers of these agencies, see generally 1 M. MALLOY, *supra* note 27, § 1.3, at 21-72.

[32] *See infra* note 52 and accompanying text.

[33] *See infra* notes 53-68 and accompanying text.

[34] *See generally, e.g.*, 1 M. MALLOY, *supra* note 27, § 1.4, at 72-79.

[35] *See infra* text accompanying notes 167-68.

[36] *See infra* text accompanying notes 448-52.

With the convergence of thrift and commercial bank business, and the kinds of claims in receivership that this business tends to generate, the differences between the in-house, administrative claims determination procedures employed by the FHLBB and the FSLIC, on the one hand, and the external, judicial procedures relied upon by the FDIC, on the other, have begun to appear anomalous. It is not surprising, therefore, that those opposing the *Hudspeth* doctrine have argued that if the FDIC can rely on judicial settlement of creditors' claims, so too should the FSLIC.[38]

Yet one should not overlook the historical differences between commercial bank and thrift regulation, or the differences that still remain. The notion of a separately regulated thrift industry is premised upon the long-standing American concern for the protection and encouragement of private home ownership. It has been thought important that funds should always be channeled in the direction of private home purchasers, and the concept of joint commercial bank/thrift regulation carries with it the danger that the private home buyer would be unable to compete for credit in the commercial marketplace.[39] This concern has tended to promote a paternalistic outlook on the part of the thrift regulators, one that perhaps contributes to the desire to maintain an internal, self-sufficient and inexpensive liquidation process.

B. *Development and Structure of the Regulatory Framework.*

Before 1932 the federal government had no involvement in the thrift industry. State chartering and regulation of thrifts had existed, however, in a number of states since the early nineteenth century.[40] Thrifts, bearing various titles such as "building associations," "savings and loan associations," and "savings banks," were chartered under the laws of the various states and were usually confined to narrowly localized operations.[41] They were also subjected to increasingly intensive regulation and supervision, especially during the latter quarter of the nineteenth century.[42]

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[37] For an indication of the scale of recent litigation, see *infra* notes 228-43.

[38] *See infra* text accompanying notes 430-46.

[39] *See, e.g.*, Gray, *The Role of Regulation in the Thrift Industry*, 6 ANN. REV. BANKING L. 235, 236-37 (1987); Wallace, *Home Ownership Drives the Thrift System*, OUTLOOK, Sept.-Oct. 1986, at 9.

[40] *See generally* W. LOVETT, *supra* note 30, at 232-35; E. SYMONS & J. WHITE, BANKING LAW 51-52, 54-56 (2d ed. 1984); UNITED STATES BLDG. & LOAN LEAGUE, HISTORY OF BUILDING AND LOAN IN THE UNITED STATES 123-32 (H. Bodfish ed. 1931) [hereinafter HISTORY OF BUILDING AND LOAN]; Barth & Regalia, *The Evolving Role of Regulation in the Savings and Loan Indus-*

Federal regulation of the thrift industry came in the wake of major legislation governing commercial banks,[43] and commenced with the creation of the Home Loan Bank System in 1932.[44] More important was the enactment of the Home Owners' Loan Act of 1933,[45] which empowered the recently created FHLBB[46] to charter federal savings and loan associations and subject them to the FHLBB's regulation. A year later Congress established the FSLIC to provide federal deposit insurance for, exercise supervision over, and act as conservator or receiver in respect of, federal thrifts. At their option or that of their chartering state, state-chartered building associations, savings and loan associations, homestead associations and cooperative banks could also apply for FSLIC insurance. The insurance fund was to be self-financing and replenished from premiums levied on the deposits of insured thrifts. The FSLIC was to act under the direction of the FHLBB.[47]

During the ensuing four decades the powers and jurisdiction of the FHLBB and FSLIC were extended in various directions (often together with those of the FDIC in respect of commercial banks). The FHLBB, for example, was granted powers to issue cease and desist orders, appoint the FSLIC as receiver for state-chartered thrifts, charter savings banks,

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try, in The Financial Services Revolution, *supra* note 24, at 113, 115-24; Lockwood, *Thrift Industry Passes Its 170th Anniversary*, Outlook, Sept.-Oct. 1986, at 20. For a fuller discussion of the directly relevant legislative history, see *infra* notes 355-419 and accompanying text.

[41] National institutions, which operated through branch offices and the mail, were driven out of business by opposition, largely from local thrifts and their lobby, the U.S. Savings and Loan League, during the economic depression of the 1890s. *See* W. Lovett, *supra* note 30, at 246-47; History of Building and Loan, *supra* note 40, at 105-15; Barth & Regalia, *supra* note 40, at 120.

[42] *See* History of Building and Loan, *supra* note 40, at 123-29; W. Lovett, *supra* note 30, at 247.

[43] Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. §§ 1811-1832 (1982)). This legislation created the FDIC and, adding § 12(B) to the Federal Reserve Act, ch. 6, 38 Stat. 251 (1913), established a system of federal deposit insurance for banks. Section 12(B) was later designated as a separate act, known as the Federal Deposit Insurance Act. *See* Act of September 21, 1950, ch. 967, § 1, 64 Stat. 873 (codified at 12 U.S.C. § 264 (1982)).

[44] Federal Home Loan Bank Act of 1932, ch. 522, § 17, 47 Stat. 725, 736-37 (codified as amended at 12 U.S.C. § 1437 (1982)) (creating the Federal Home Loan Bank Board and twelve home loan bank districts); *see also infra* text accompanying notes 357-60.

[45] Ch. 64, 48 Stat. 128 (codified as amended at 12 U.S.C. § 1464 (1982)).

[46] *See supra* note 44 and accompanying text.

[47] National Housing Act of 1934 § 402, 12 U.S.C. § 1725 (1982) (current section includes minor amendments to original section 402).

and convert state thrifts to federal charter. The FSLIC was given powers to terminate federal insurance, extend financial assistance to troubled thrifts, and borrow money to replenish its insurance fund.[48]

The picture that emerges is that of the FHLBB exercising chartering and directory powers over two insuring agencies, the FSLIC and the FDIC (in the limited case of federal savings banks), each of which in turn exercises extensive regulatory powers over the thrifts insured by them and each of which is appointed in a separate institutional capacity as the receiver of any such thrifts when they fail.

Concern for protecting small investors has not been the only force driving the growth of federal thrift regulation. Thrifts are an important element in the maintenance of the public supply of money,[49] and the maintenance of public confidence in the thrift system is thought to be an essential national concern.[50] It is not surprising, therefore, that "the financial industry, particularly the depository institutions segment, is one of the most heavily regulated industries in America."[51]

C. *Transformation of the Thrift Industry.*

The original function of savings and loan associations was the narrow one of receiving deposits from would-be home owners and providing loans to depositors for the purpose of building or acquiring real property, particularly housing. Only at a later stage did savings and loan associations begin lending to borrowers who were not also their depositors. Savings banks, on the other hand, were philanthropic, being originally designed to provide financial services for the small saver. The only significant creditors of both savings and loan associations and savings banks, traditionally, were their depositors.[52]

In recent years, however, savings and loan associations and savings banks have not only tended to converge, both structurally and functionally,[53] but they have become exposed to a novel range of concerns. From

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48. *See infra* text accompanying notes 388-419 (describing some of the relevant legislation).

49. *See* M. FRIEDMAN & A. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES 1867-1960, at 662-72 (1963).

50. *See, e.g.*, Barth, Brumbaugh, Sauerhaft & Wang, *supra* note 24, at 2-3; Note, *The "Brokered Deposit" Regulation: A Response to the FDIC's and FHLBB's Efforts to Limit Deposit Insurance*, 33 UCLA L. REV. 594, 603-04 (1985).

51. Barth & Regalia, *supra* note 40, at 114; *cf.* Fahey v. Mallonnee, 332 U.S. 245, 250 (1947) (Jackson, J.) ("Banking is one of the longest regulated and most closely supervised of all public callings." (referring to the regulatory powers of the FHLBB)).

52. *See generally* FEDERAL HOME LOAN BANK SYSTEM, A GUIDE TO THE FEDERAL HOME LOAN BANK SYSTEM 5-6 (5th ed. 1987) [hereinafter FHLB GUIDE]; HISTORY OF BUILDING AND LOAN, *supra* note 40, at 11-18; Barth & Regalia, *supra* note 40, at 115-16; Gray, *supra* note 39, at 238-40; Lockwood, *supra* note 40, at 20.

53. *See, e.g.*, E. SYMONS & J. WHITE, *supra* note 40, at 57-58.

the early 1960s, a series of developments completely altered the economic environment within which thrifts function. The most important of these developments were: (i) increasing competition between thrifts and banks; (ii) the deregulation and volatility of interest rates; and (iii) the decline in inflation and the collapse of the oil boom.[54]

In the 1960s, thrifts found themselves under increasing competition from commercial banks for small savers. The Fed permitted banks to pay higher interest rates on certain popular kinds of deposits, and thrifts suffered severe disintermediation (loss of funds). The Act of September 21, 1966,[55] which permitted thrifts to offer slightly higher rates on savings deposits than commercial banks, restored some protection for thrifts.[56] But, with the passage of the Housing and Urban Development Act of 1968,[57] which gave thrifts broader investment powers, thrifts entered into direct competition with banks in the provision of many financial services.

By the late 1970s both banks and thrifts were facing external competition from money market funds. This development induced Congress to enact the Depository Institutions Deregulation and Monetary Control Act of 1980,[58] the purpose of which was to phase out ceilings on maximum interest rates. But one effect was to plunge thrifts into a "trial by interest rates"[59] as they competed for deposits while finding themselves locked into long-term mortgages that bore much lower rates of return.[60]

Attempting to resolve this dilemma, Congress enacted the Garn-St Germain Depository Institutions Act of 1982.[61] The Act allowed thrifts to diversify and expand their portfolios into other investments, subject to a limitation that these new assets not exceed 10% of their total assets. Some states, including California and Texas, went further and lifted all asset limitations from their state-chartered thrifts.[62] Deregulation paved the way for thrifts to enter whole new areas of business activity and, through high-risk business ventures accompanied by the ability to offer automatic federal insurance to potential depositors,[63] to grow at "astronomical rates" until the FHLBB placed caps on growth rates in 1983.[64]

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[54] *See generally* F. BALDERSTON, THRIFTS IN CRISIS 4-9 (1985); A. CARRON, THE PLIGHT OF THE THRIFT INSTITUTIONS 11-21 (1982); FHLB GUIDE, *supra* note 52, at 13-23; W. LOVETT, *supra* note 30, at 227-32; Kriz, *The Sick Get Sicker*, 1987 NAT'L J. 874, 875-76; Pfeiler, *FSLIC Adjudication of Claims Against Receiverships: Has the Search for Efficiency Lost Sight of Due Process?*, 53 LEGAL BULL. 433, 433 n.1 (1987); Note, *supra* note 50, at 608-12.

[55] Pub. L. No. 89-597, 80 Stat. 823 (codified in scattered sections of 12 U.S.C.) (amending the Federal Reserve Act, Federal Deposit Insurance Act, and Federal Home Loan Bank Act).

[56] *See, e.g.*, Lockwood, *supra* note 40, at 23.

[57] Pub. L. No. 90-448, 82 Stat. 476 (codified in scattered sections of 12 U.S.C. ch. 13).

[58] Pub. L. No. 96-221, 94 Stat. 132 (codified at 12 U.S.C. §§ 3501-3524 (1982)).

[59] FHLB GUIDE, *supra* note 52, at 18.

[60] *See* F. BALDERSTON, *supra* note 54, at 5-6; A. CARRON, *supra* note 54, at 12-13.

[61] Pub. L. No. 97-320, 96 Stat. 1469 (codified in scattered sections of 12 U.S.C.).

[62] For a recent survey of the extensive difficulties currently confronting state-chartered and state-regulated thrifts, see Bancroft, *Banking on Deregulation Can Be Hazardous to Your State's Financial Institutions*, GOVERNING, Jan. 1988, at 44.

The next blow came from the decline in the inflation rate and the sudden slump in oil-driven economic prosperity, particularly in the Southwest. Anticipating exponential increases in the value of real estate, thrift managers had often grossly overextended themselves.[65] When the oil boom ended, the poor asset quality of their investments threw well over 100 thrifts into difficulties with the FHLBB's minimum asset requirements, and dozens immediately became insolvent.[66] Hence the primary cause of thrift failure had shifted by the mid-1980s from the interest rate squeeze of the late 70s and early 80s to imprudent investment strategies,[67] and a major contribution to the difficulties in which thrifts have found themselves has been the relative inexperience of thrift managers in the new areas of enterprise into which deregulation has so rapidly thrust them.[68]

Finally, the Tax Reform Act of 1986,[69] which adversely affected the value of real estate development, has probably also had a significant impact on the asset portfolios of the more fragile thrifts.[70]

D. *Escalation of Thrift Failures and Depletion of the FSLIC's Insurance Fund.*

To cope with the ailing state of the industry, Congress has given the FHLBB broader powers for dealing with failed or failing thrifts,[71] and the FHLBB has taken various forms of action itself. For example, in 1976 it promulgated a regulation permitting federal thrifts to incorporate "due-on-sale" clauses in their loan instruments as a device for escaping their commitments on sales of the mortgaged property.[72] In 1985 the FHLBB issued a rule requiring supervisory approval of direct investment by FSLIC-insured thrifts in excess of certain specified thresholds.[73] A "management consignment program," designed to enable the FSLIC to take control and improve the health of troubled thrifts before they become too great a burden on the FSLIC, has been instituted,[74] and, in an effort to improve the quantity and quality of its regulatory supervision force, the Board has transferred its examination functions and examiners to the twelve District Banks.[75]

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[63] On the distortions produced by the deposit insurance "subsidy," see E. KANE, *supra* note 24, ch. 5.

[64] *See* Kriz, *supra* note 54, at 875-76.

[65] *See id.* at 877; Note, *supra* note 50, at 611-12.

[66] *See* Kriz, *supra* note 54, at 877.

[67] "In [1982], most of the thrift problems stemmed from interest rate risk (spread problems), whereas in 1986 the cases were almost exclusively related to credit risk (bad-asset cases)." 1986 FHLBB ANN. REP. 26-27 (1987).

[68] Speaking on the diversification permitted thrifts as a result of the Garn-St Germain Depositary Institutions Act, the former general counsel of the FHLBB, Harry Quillian, has remarked, " 'You had 4,500 institutions at that time that were suddenly thrown into, or thought they must jump into, business activities that they were not used to and not really prepared for, to make more money to recoup their positions,'. . . . " Kriz, *supra* note 54, at 875.

Managerial incompetence, however, is not confined to ailing thrifts. According to the Comptroller of the Currency, citing a study of the causes of bank failures from 1979 to 1987, "banks continue to fail the old-fashioned way: through managerial incompetence . . . ." *Bank-Failure Causes Cited,* N.Y. Times, Jan. 21, 1988, at D9, col. 5 (city ed.).

[69] Pub. L. No. 99-514, 100 Stat. 2085 (codified in scattered sections of 26 U.S.C.A.).

[70] For an analysis of the Act's likely impact on real estate and mortgages, see Johnson, *Financial Impact of the 1986 Act on Real Estate Investments—A View from the Spreadsheets,* 36 TAX NOTES 309 (1987).

[71] *See infra* text accompanying notes 407-19.

These and other measures,[76] while helping to contain the problem, have not proven enough to stem the tide. The number of "brain dead" and "terminally ill" thrifts[77] that are so irretrievable as to compel their liquidation has grown rapidly in recent years. Whereas during the entire period from 1934 to 1980 the FHLBB put only 13 thrifts into liquidation, in 1987 alone it put 25 into receivership and liquidated 17,[78] and the

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[72] 12 C.F.R. § 545.34(a) (1988); *see* Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U.S. 141 (1982) (upholding the validity of the regulation over state law prohibiting such clauses). Express preemption, under certain circumstances, of due-on-sale provisions was incorporated in the Thrift Institutions Restructuring Act, Pub. L. No. 97-320, § 341, 96 Stat. 1496, 1505 (1982) (codified at 12 U.S.C. § 1701j-3 (1982)).

[73] *See* 1985 FHLBB ANN. REP. 17 (1986). This measure was bolstered by the Thrift Industry Recovery Act, Pub. L. No. 100-86, § 406, 101 Stat. 604, 614 (1987) (codified at 12 U.S.C.A. § 1464 (West Supp. 1988)), which empowers the FHLBB to establish minimum capital requirements and to treat the failure to observe these requirements as an unsound or unsafe practice.

[74] *See* 1986 FHLBB ANN. REP. 17, 28 (1987). *But see infra* note 152.

[75] *See* 1985 FHLBB ANN. REP. 21 (1986); Gray, *supra* note 39, at 242-44.

[76] *See, e.g.*, Pfeiler, *supra* note 54, at 434 n.4 (restructuring and increasing staff size).

[77] *See* Kriz, *supra* note 54, at 875.

[78] The number of receiverships during the life of the FSLIC is as follows:

1934-39 — 0
1940-41 — 7
1942-65 — 0
1966-71 — 6
1972-80 — 0
1981 — 1
1982 — 1
1983 — 6
1984 — 9
1985 — 11
1986 — 21
1987 — 25
1988 (to July 1) — 30

See 1986 FHLBB ANN. REP. 31-35 (1987); FHLB GUIDE, *supra* note 52, at 18, 21-22; Grant, *The FSLIC: Protection Through Professionalism*, FHLBB J., Feb. 1981, at 9; telephone interview with Judith L. Friedman, Associate General Counsel, FHLBB (Aug. 29, 1988). In addition, 24 thrifts were placed into the management consignment plan in 1987 and one more added as of July 1, 1988. *Id.*

Board's present chairman recently estimated that the agency will close one thrift a week in 1988.[79] In Texas alone the FHLBB plans to close or merge 104 thrifts during 1988.[80]

The potential magnitude of receivership claims is evident from the fact that approximately 340, and perhaps as many as 510,[81] thrifts—representing 10% of the industry—are currently estimated to be insolvent.[82] The pressure of depositor payouts drove the federal insurance fund itself into a $6.3 billion deficit by the beginning of 1987.[83] A congressional/executive compromise culminated in the Competitive Equality Banking Act of 1987,[84] title III of which authorized the FSLIC to recapitalize its insurance fund (thereby enabling a fresh batch of moribund thrifts to be put into receivership).

Yet even this measure has proved inadequate. Healthy thrifts have protested their obligation to support, through the emergency special insurance assessments levied on their deposits, the mismanagement of their ailing counterparts. Those eligible to do so have embarked upon a "silent run," electing to leave the FSLIC insurance system and seek FDIC insurance.[85] Some thrift industry experts believe a second bailout, possibly involving an appropriation of taxpayer funds, will soon be required.[86] And the General Accounting Office recently reported to the Senate

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[79] *See* Day, *More Hard Times for S & Ls*, Wash. Post, Dec. 21, 1987, at 22, cols. 1, 4 (weekly ed.). By late July, 44 thrifts had actually failed in 1988, as compared with 48 for the whole of 1987. *See* Hilder, *Shaky Coverage*, Wall St. J., July 27, 1988, at 1, col. 6, 16, col. 2.

[80] *See* Hayes, *Bank Board Plan Near on Texas Savings Units*, N.Y. Times, Jan. 16, 1988, at 21, col. 5 (national ed.) (Texas's "troubles represent about half of our problems nationwide." (quoting M. Danny Wall, Chairman, FHLBB)). In the space of six weeks the FHLBB recently had to double the estimate of its costs in closing or merging insolvent Texas thrifts, from $7 billion to $15.2 billion. *See* Nash, *Bank Board Doubles Texas Cost Estimate*, N.Y. Times, July 8, 1988, at 23, col. 4 (national ed.).

[81] The amount varies according to whether generally accepted accounting principles, which the thrift industry will have to use beginning in 1989, or regulatory accounting principles, which produce lower figures, are used. *See* Nash, *Record Loss for Savings Industry*, N.Y. Times, March 25, 1988, at D1, cols. 3, 5 (city ed.).

[82] *See* Day, *supra* note 79, at 22, col. 3; Hayes, *supra* note 80, Nash, *supra* note 81, at D1, cols. 3-5. In a report to the Senate Banking Committee, the General Accounting Office recently noted that the FHLBB has identified more than 200 hopelessly insolvent thrifts and another 300 that are insolvent under generally accepted accounting principles. *See* Nash, *A Gloomy Report on F.S.L.I.C.*, N.Y. Times, May 20, 1988, at 27, col. 3, 28, col. 3 (national ed.).

[83] *See* 1986 FHLBB ANN. REP. 25 (1987).

[84] Pub. L. No. 100-86, 101 Stat. 552 (to be codified in scattered sections of 12 U.S.C.A.).

[85] *See* Nash, *FSLIC's Second Bailout Is Studied*, N.Y. Times, Mar. 7, 1988, at 23, col. 6, 26, cols. 3-4 (national ed.).

[86] *See id.* at 23, col. 6. This situation has led one of the nation's major thrift industry lobbies, the National Council of Savings Institutions, among others, to propose a contingency plan involving the merger of the FSLIC and the FDIC and their insurance funds. *See id.* at 26, col. 1; Statement by J. Morgan, Chairman of the National Council of Savings Institutions, Washington, D.C. (Mar. 2, 1988).

Banking Committee that at the end of 1987 the federal insurance fund deficit had grown to $13.7 billion—more than twice the level at which it had stood only one year before.[87]

Pressures on the insurance fund have been accompanied by an escalation in the costs of administering the increasing volume of receiverships. For example, in 1986 alone annual insurance settlement and administrative costs increased from $31.2 million to nearly $57 million.[88]

E. *Reaction and Adaptation at the FHLBB.*

The financial difficulties of the Insurance Fund, and the rapid increase in the cost of assisting and liquidating failed thrifts, forced the FHLBB and FSLIC to investigate ways of reducing expenses and expediting its procedures. For those thrifts that are thought to be salvageable, the FHLBB and the FSLIC have developed various techniques designed to avoid either having to place a thrift in receivership[89] or, if this is unavoidable, having to liquidate it once it has been placed in receivership.[90] In these ways the FSLIC has been able to reduce significantly the actual and potential payouts from the insurance fund that it might otherwise have to make.

The agencies have also tried to contain the costs of receiverships by developing exclusive, internal claims adjudication procedures. The importance to the agencies of these procedures is expressed in a report, referring to the FSLIC's victory in the *Hudspeth* decision,[91] by the Litigation and Special Projects Division of the FHLBB's Office of General Council:

> The Division won a significant decision establishing the exclusivity of the FSLIC's procedures for administrative adjudication of creditors' claims against the assets of institutions in receivership. The decision confirmed that the FSLIC, as receiver, must make an initial determina-

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[87] *See* Nash, *supra* note 82, at 27, col. 3. A short while earlier the FHLBB itself announced that at the end of 1987 the federal insurance fund deficit had grown to $11.6 billion. *See* Day, *Deficit Growing at FSLIC,* Wash. Post, Apr. 18, 1988, at A1, A8; Nash, *Fund to Insure Savings Industry in Critical State,* N.Y. Times, Apr. 19, 1988, at 1, col. 1 (national ed.). More recently, the chairman of the FHLBB and an undersecretary of the Treasury estimated that an amount of $30 billion would be required to bail out the nation's thrift industry. *See* Nash, *Treasury Says Savings Aid Shouldn't Tax the Taxpayer,* N.Y. Times, Aug. 3, 1988, at 25, col. 4 (national ed.) (reporting on hearings conducted by the Senate Banking Committee). The following day the chairman of the FDIC disagreed, stating that in his view a sum of $50 billion was required. *See* Hershey, *FSLIC's Need Put at $50 Billion,* N.Y. Times, Aug. 4, 1988, at 25, col. 6 (national ed.).

[88] *See* 1986 FHLBB ANN. REP. 25 (1987). According to one report, legal fees charged to the FSLIC by outside counsel rose to $87 million for 1987, compared with $37 million for 1986. *See* Brogan, *Bank Failures Spell Success for Firms,* Legal Times, June 6, 1988, at 4, col. 1.

[89] *See infra* text accompanying notes 149-52.

[90] *See infra* text accompanying notes 189-95.

[91] *See infra* text accompanying notes 98-117.

> tion concerning the validity and priority of a creditor's claim, with further administrative review by the Board, before the courts may intervene. This decision will promote the efficiency of the liquidation process and result in enormous savings in legal fees.[92]

The administrative procedures existing when *Hudspeth* was decided were virtually nonexistent, however, so the Adjudication Division of the Office of General Counsel of the FHLBB has since been engaged in developing new procedures. This process remains incomplete: a series of proposed and interim rules amending existing procedures have been published since late 1985, but final rules have still not been published by the Board.[93] Meanwhile, however, the agencies have found themselves embroiled in litigation challenging both the statutory and the constitutional bases of their asserted adjudicative power.[94] Hence the procedures that have so far been instituted remain not only fluid and experimental but also of uncertain legal status.

F. *Conflict in the Courts.*

To establish and enforce its asserted power as receiver to adjudicate creditors' claims, the FSLIC has adopted the practice of seeking to have claims suits that have been initiated in state courts removed to the federal courts, where the FSLIC then moves for them to be dismissed for want of subject matter jurisdiction. The FSLIC's argument is that, as receiver, it has been vested with the power to determine for itself the validity of creditor claims,[95] and that the jurisdiction of the courts to make independent determinations has been precluded.[96]

This strategy has often proved successful. Having secured some acknowledgement of its position from the federal district court in Hawaii,[97] the FSLIC's interpretation of the legislation was firmly endorsed by the Fifth Circuit in *North Mississippi Savings & Loan Association v. Hudspeth,*[98] which quickly became the leading case on the subject.

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[92] 1985 FHLBB ANN. REP. 46 (1986). On the other hand, the motives underlying the agencies' propagation of the *Hudspeth* doctrine have been questioned by a former General Counsel of the FHLBB. *See* Leibold, The Hudspeth Doctrine: Its Conception, Birth and Possible Demise 1 (Oct. 6-7, 1988) (unpublished paper to be delivered at ALI-ABA Course of Study: Failing Financial Institutions, Washington, D.C.) ("The *Hudspeth* doctrine was conceived because, I believe, legal counsel for the FSLIC, not as receiver but as insurer-creditor, although counsel were wearing both hats, attempted to raise any possible legal argument to frustrate what they concluded to be 'black hat' creditors who had obtained verdicts or judgments in civil courts, usually prior to the appointment of a receiver for the association.").

[93] *See infra* text accompanying notes 201-05.

[94] *See infra* notes 97-148 and accompanying text.

[95] The FSLIC relies on § 406(d) of the National Housing Act of 1934, 12 U.S.C. § 1729(d) (Supp. IV 1986). *See infra* text accompanying note 186 (quoting the subsection).

[96] Here the FSLIC relies on § 5(d) of the Home Owners' Loan Act of 1933, 12 U.S.C. § 1464(d)(6)(C) (1982). *See infra* text accompanying note 178 (quoting the subsection).

[97] *See* First Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 531 F. Supp. 251, 255-56 (D. Haw. 1981); *cf.* First Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 547 F. Supp. 988, 994, 996-97 (D. Haw. 1982). *Contra* W-V Enters. v. FSLIC, 234 Kan. 354, 372, 673 P.2d 1112, 1125 (1983)

1. Hudspeth: *The "Administrative Track."* *Hudspeth* involved a dispute between a thrift (Old North) and its former president (Hudspeth). When in 1977 Mississippi law required all state-chartered thrifts to obtain FSLIC insurance, the FSLIC refused to approve insurance for Old North unless Hudspeth was replaced. He resigned and Old North began paying him a regular monthly amount, which Hudspeth claimed to be a deferred compensation agreement. This agreement was repudiated by Old North in 1982, when the thrift filed in Mississippi chancery court for a declaration that the agreement either did not exist or was terminable. Hudspeth filed a counterclaim for contractual damages and specific performance.

During these proceedings the State of Mississippi placed Old North in receivership and appointed the FSLIC as receiver. On the same day the FHLBB federalized the receivership and named the FSLIC as sole receiver.[99] The FSLIC, following one of its usual practices in liquidations,[100] then formed a new thrift (New North) and transferred to New North all of Old North's assets and liabilities except its liabilities to stockholders and any obligation owed to Hudspeth. The FSLIC then terminated payments to the former president.

After the FSLIC, as receiver for Old North, had unsuccessfully moved for dismissal of Hudspeth's counterclaim, Hudspeth filed an amended counterclaim joining New North as a party, the latter being an alleged transferee in interest. The FSLIC and New North then removed the action to a federal court and moved sucessfully to dismiss the counterclaim. Hudspeth's motion to remand to state court was denied. The

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(FSLIC unsuccessfully argues for the dissolution of an attachment order on the grounds that the order "interfere[d] with its liquidation of [the defendant thrift]").

[98] 756 F.2d 1096 (1985), *cert. denied,* 474 U.S. 1054 (1986). The scope of this decision is not clear. For example, the Fifth Circuit has declared *Hudspeth* inapplicable to the resolution of claims liabilities assumed by transferee thrifts in a purchase and assumption transaction. *See* Bean v. Independent Am. Sav. Ass'n, 838 F.2d 739, 742 (5th Cir. 1988). *Hudspeth* was also ignored in a case in which the FSLIC unsuccessfully asserted exclusive jurisdiction to determine whether certain deposits were insured. *See* Jugum v. FSLIC, 637 F. Supp. 1045, 1048 (W.D. Wash. 1986); *cf.* Herbert v. National Credit Union Admin. Bd., 663 F. Supp. 833, 839-44 (E.D. Mo. 1987) (doubting *Hudspeth*'s applicability in the case of insured deposits). On the justiciability of insurance claims, see *infra* text accompanying notes 468-72.

[99] For the conditions under which this is permissible, see *infra* text accompanying notes 170-75.

[100] *See infra* text accompanying note 193.

case then took a remarkable course: a panel of the Fifth Circuit[101] first upheld Hudspeth's appeal in part,[102] then a few weeks later dismissed it altogether.[103]

In its withdrawn opinion, the court had agreed that the presence of New North and the FSLIC rendered the action removable to the federal court, and the panel agreed that the district court had "properly dismissed all of Hudspeth's claims against New North and much of his action against Old North."[104] The court accepted that Hudspeth's assertion that the FSLIC was not authorized to set aside his contract was, as a result of the operation of 12 U.S.C. sections 1464(d)(6)(C) and 1729(d),[105] "route[d] to the administrative process."[106] But the court concluded that Hudspeth's claim against Old North for payment of past services rendered was not barred and should be remanded to the state court.[107] The panel agreed with Hudspeth that neither section 1464(d)(6)(C) nor section 1729(d) barred the judicial determination of the validity of Hudspeth's claim against Old North. Relying upon Supreme Court decisions,[108] the court took the view that "the adjudication of claims against a debtor, as opposed to the allocation of assets to satisfy those claims, is not a receivership function."[109]

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[101] Judge Higginbotham wrote the panel's opinions, with Judges Thornberry and Reavley concurring.

[102] The court's initial opinion, dated April 5, 1985, was reported in West's advance sheets as North Miss. Sav. & Loan Ass'n v. Hudspeth, 756 F.2d 1096 (5th Cir. 1985) [hereinafter *Hudspeth*, withdrawn]. The opinion is reprinted as Appendix A to Pfeiler, *supra* note 54, app. at 471-75.

[103] The second opinion is contained in West's bound volume. *See* North Miss. Sav. & Loan Ass'n v. Hudspeth, 756 F.2d 1096 (5th Cir. 1985), *cert. denied*, 474 U.S. 1054 (1986) [hereinafter *Hudspeth*].

[104] *Hudspeth*, withdrawn, *supra* note 102, 756 F.2d at 1098.

[105] *See supra* text accompanying notes 95-96.

[106] *See Hudspeth*, withdrawn, *supra* note 102, 756 F.2d at 1101.

[107] *See id.* at 1098-99, 1103. The court had been briefed on the possible unconstitutionality of the FSLIC's claimed adjudicative powers and on the question whether the statutory authority to adjudicate existed; in its opinion, however, the court, chose to address only the issue of statutory adjudicative authority. The constitutional questions raised were whether the claimed adjudicative power violated article III of the U.S. Constitution, whether the administrative procedures available for determining the claim were inadequate when measured against the requirements of procedural due process, and whether the FSLIC's conflict of interest in determining claims while being one of the creditors violated due process. Telephone interview with Wylene W. Dunbar, counsel for Hudspeth (Mar. 18, 1988).

[108] Underwriters Nat'l Assur. Co. v. North Carolina Life & Accident & Health Ins. Guar. Ass'n, 455 U.S. 691, 711 n.19 (1982); Morris v. Jones, 329 U.S. 545 (1947); Riehle v. Margolies, 279 U.S. 218 (1929); *cf.* Tcherepnin v. Knight, 389 U.S. 332, 346 (1967) (determination of *existence* of a "security" is distinct from question of the *priority* of claims in receivership, and is a justiciable issue); Chicago Title & Trust Co. v. Fox Theatres Corp., 69 F.2d 60, 61 (2d Cir. 1934) (determination, or "liquidation," of creditor claim is a proceeding in personam against insolvent debtor, and does not directly deal with receivership assets or receivership itself); Tocci Corp. v. Yankee Bank for Fin. & Sav., FSB, No. Civ. A. 87-3121-K (D. Mass. 1988) (Westlaw, 1988 WL 70344) ("At common law, receivers have no power to adjudicate claims.").

The FSLIC then petitioned for rehearing, arguing that the effect of the court's decision would be to place in further jeopardy the already precarious insurance fund. The FSLIC referred to the legislative history of the 1966 and 1968 amendments to the powers of the FHLBB and FSLIC in support of its argument that, as receiver, it possessed the exclusive power to adjudicate creditor claims.[110] Hudspeth was not called upon to respond to the petition.[111] The court decided to revise its decision, this time accepting the FSLIC's arguments in their entirety, and the Supreme Court subsequently denied Hudspeth's petition for certiorari.[112]

In its revised opinion, the panel adopted the view that legislative history[113] indicated that "Congress wanted the FSLIC to be able to act quickly and decisively in reorganizing, operating, or dissolving a failed institution,"[114] and that the legislation expressed "the overriding Congressional purpose of expediting and facilitating the FSLIC's task as receiver."[115] Hence, Judge Higginbotham opined, "resolution of even the facial merits of claims outside of the statutory reorganization process would delay the receivership function of distribution of assets"[116] and, in violation of section 1464(d)(6)(C), would constitute a restraint of the receivership. He concluded:

> In short, all of Hudspeth's claims are switched to the administrative track by section 1464(d)(6)(C). Hudspeth can challenge the FSLIC's actions before the FHLBB, and, if unsatisfied, can seek judicial review under the APA.[117]

The revised *Hudspeth* decision was a major victory for the FHLBB and the FSLIC. It was rapidly followed in a host of district court decisions,[118] in those of a significant number of state courts,[119] and has been reaffirmed in a series of subsequent Fifth Circuit decisions.[120] It was also followed in a somewhat equivocal decision of the Seventh Circuit.[121] In addition, a panel of the Ninth Circuit, dealing with the special case[122] of a claim brought by an insolvent thrift against the FSLIC for having allegedly transferred its assets negligently to a buyer, has held that section 1464(d)(6)(C) strips the district courts of jurisdiction to hear the action.[123]

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[109] *See Hudspeth,* withdrawn, *supra* note 102, 756 F.2d at 1102. The court's conclusion is worth noting, since it rests upon a long-standing distinction between the recognition of pre-receivership claims and the exercise of general receivership powers. The court concluded:

> When read in concert, 12 U.S.C. §§ 1464(d)(6)(C), 1729, and 1730(k)(1) construct an orderly scheme. In suits against a state savings institution in a federalized receivership, where the relief requested would interfere with or overturn the effect of any exercise of receivership power, the suit must be dismissed in favor of administrative proceedings before the FHLBB. If, however, an action is based on the pre-receivership conduct of the failed institution, the debt due may be judicially established.

Id. at 1103. On the distinction, see *infra* text accompanying notes 347-53. On subsection 1730(k)(1), see *infra* text accompanying notes 449-52.

[110] On this legislative history, see *infra* text accompanying notes 395-412.

[111] Telephone interview, *supra* note 107.

[112] Hudspeth v. North Miss. Sav. & Loan Ass'n, 474 U.S. 1054 (1986).

[113] On the court's use of the legislative history, see *infra* notes 381-410.

[114] *Hudspeth, supra* note 103, 756 F.2d at 1101.

[115] *Id.* at 1102.

[116] *Id.*

[117] *Id.* at 1103.

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[118] *See* Blakely Airport Joint Venture II v. FSLIC, 678 F. Supp. 154 (N.D. Tex. 1988); Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104 (D. Kan. 1988); Vernon Sav. & Loan Ass'n v. Homes Int'l Dev. Corp., 676 F. Supp. 247 (S.D. Fla. 1988); Resna Assocs. v. Financial Equity Mortgage Corp., 673 F. Supp. 1371 (D.N.J. 1987); FSLIC v. Florida 100 Dev. Group, 670 F. Supp. 1577 (S.D. Fla. 1987); York Bank & Trust Co. v. FSLIC, 663 F. Supp. 1100 (M.D. Pa. 1987), *vacated and remanded*, 851 F.2d 637 (3d Cir. 1988); Acquisition Corp. of Am. v. Sunrise Sav. & Loan Ass'n, 659 F. Supp. 138 (S.D. Fla. 1987); FSLIC v. Oldenburg, 658 F. Supp. 609 (D. Utah 1987); FSLIC v. Hall Whispertree Assocs., 653 F. Supp. 148 (N.D. Tex. 1986); Kohlbeck v. Kis, 651 F. Supp. 1233 (D. Mont. 1987); FSLIC v. Quality Inns, Inc., 650 F. Supp. 918 (D. Md. 1987); Baskes v. FSLIC, 649 F. Supp. 1358 (N.D. Ill. 1986); Baer v. Abel, 649 F. Supp. 25 (W.D. Wash. 1986); Baer v. Abel, 648 F. Supp. 69 (W.D. Wash. 1986); Colony First Fed. Sav. & Loan Ass'n v. FSLIC, 643 F. Supp. 410 (C.D. Cal. 1986); FSLIC v. Sajovich, 642 F. Supp. 74 (C.D. Cal. 1986); Sunrise Sav. & Loan Ass'n v. Lir Dev. Co., 641 F. Supp. 744 (S.D. Fla. 1986); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93 (W.D. Wash. 1986); Rembold v. Gibraltar Sav. & Loan Ass'n, 624 F. Supp. 1006 (W.D. Wash. 1985), *rev'd sub nom.* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); Murdock-SC Assocs. v. Beverly Hills Fed. Sav. & Loan Ass'n, 624 F. Supp. 948 (C.D. Cal. 1985), *aff'd in part and rev'd in part*, 815 F.2d 82 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Murdock-SC Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-452); Gibraltar Bldg. & Loan Ass'n v. State Sav. & Loan Ass'n, 607 F. Supp. 722 (N.D. Cal. 1985); *cf.* First Fin. Sav. & Loan v. FSLIC, 651 F. Supp. 1289 (E.D. Ark. 1987) (*Hudspeth* decision recognized but FSLIC held estopped from reconsidering merits of claims already determined in state court). Unreported decisions have been omitted to save space.

[119] *See* Modern Supply Co. v. FSLIC, 50 Wash. App. 194, 748 P.2d 251 (1987) (split decision); Keller v. Antioch Sav. & Loan Ass'n, 143 Ill. App. 3d 278, 492 N.E.2d 937 (1986); FSLIC v. Superior Court, 180 Cal. App. 3d 336, 225 Cal. Rptr. 422 (1986), *cert. denied*, 107 S. Ct. 949 (1987); Union County Bank v. Knox Capital Corp., No. C/A 657 (Tenn. Ct. App. Apr. 18, 1986) (Westlaw, 1986 WL 4598); *see also* FSLIC v. Kennedy, 732 S.W.2d 1 (Tex. Ct App. 1986) (recognizing the general proposition enunciated in *Hudspeth*, but rejecting the argument that the FSLIC is entitled to redetermine the validity of claims that a court and jury have already adjudicated).

[120] *See* Red Fox Indus. v. FSLIC, 832 F.2d 340, 341-42 (5th Cir. 1987); Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563, 564 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988); FSLIC v. Bonfanti, 826 F.2d 1391, 1393-94 (5th Cir. 1987), *petition for cert. filed sub nom.* Zohdi v. FSLIC, 56 U.S.L.W. 3196 (U.S. Aug. 5, 1987) (No. 87-255); Chupik Corp. v. FSLIC, 790 F.2d 1269, 1270 (5th Cir. 1986); *see also* Godwin v. FSLIC, 806 F.2d 1290, 1292-94 (5th Cir. 1987) (affirming decision of district court to deny motion for reconsideration of order granting dismissal of depositors' claim that their deposit was insured). *But cf.* Northshore Dev. v. Lee, 835 F.2d 580 (5th Cir. 1988). In *Northshore*, the court held that when a judgment has already been entered prior to receivership, FSLIC can, on the basis of the *Hudspeth* doctrine, remove the action to federal court and have it dismissed. *Id.* at 593. The court, however, then noted that this does not imply that the district court must also vacate the judgment—FSLIC must choose between pursuing an appeal or securing dismissal and accepting the judgment. *Id.* (district court's denial of motion to vacate held not an abuse of discretion).

[121] Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 828 F.2d 387 (7th Cir. 1987); *see infra* note 134.

[122] *See infra* text accompanying notes 241-43.

2. Morrison-Knudsen: *No Statutory Authority.* After a year and a half of uncritical acceptance in federal courts, the *Hudspeth* doctrine received its first major setback at the hands of a panel of the Ninth Circuit in *Morrison-Knudsen Co. v. CHG International, Inc.*[124] The case involved an insolvent, federally chartered thrift, Westside Federal Savings and Loan Association (Westside), for which the FSLIC had been appointed receiver. Westside was involved in five pre-receivership claims[125] that the FSLIC, once it had been appointed Westside's receiver, sought to have dismissed by the respective adjudicating and supervising district courts. The FSLIC's motions in the first four claims had been granted on the basis of the *Hudspeth* doctrine, but the supervising court in the motion involving the fifth claim had denied the FSLIC's motion. The Ninth Circuit ruled that there was no appellate jurisdiction in two of the claims, but reversed the orders of dismissal in the other three.

The court was faced with challenges to both the FSLIC's statutory authority to adjudicate claims and its constitutional authority to do so given the provisions of article III of the United States Constitution.[126] It engaged in an extensive analysis of the statutory framework and legislative history of the FSLIC, its powers under sections 1464(d)(6)(C) and 1729(d), and the regulations promulgated by the FHLBB for processing claims in receiverships, and concluded that the legislation was not intended to confer adjudicatory powers on the receiver.[127] While acknowledging that the FSLIC has been vested with full receivership powers, the Court rejected the assumption in the second *Hudspeth* opinion that these included adjudication.

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[123] *See* Fidelity Fin. Corp. v. FSLIC, 834 F.2d 741 (9th Cir. 1987).

[124] 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451). The Ninth Circuit opinion was written by Judge Sneed, joined by Judges Kennedy and Beezer. For a criticism of *Morrison-Knudsen,* see Huber, *Enforcement Powers of Federal Banking Agencies,* 7 ANN. REV. BANKING L. 123, 160-61 (1988) (describing the case as "a decision for the home team").

[125] In the first claim it had been impleaded as a third-party defendant, having allegedly guaranteed repayment of a loan in default for which another thrift was being sued. In the second claim, a developer (CHG), to whom Westside had lent $6.5 million, had declared bankruptcy; a co-participant in a loan agreement sought declaratory orders against Westside regarding the validity of the agreement, as well as damages and an order quieting title. The third and fourth claims against Westside involved contractual damages and equitable relief arising out of the bankruptcy of CHG. The fifth claim was filed by Westside itself in CHG's bankruptcy proceedings. *Morrison-Knudsen,* 811 F.2d at 1213.

[126] *See infra* note 538 (quoting U.S. CONST. art. III, § 1 in full).

[127] *See* 811 F.2d at 1222.

sions,[118] in those of a significant number of state courts,[119] and has been reaffirmed in a series of subsequent Fifth Circuit decisions.[120] It was also followed in a somewhat equivocal decision of the Seventh Circuit.[121] In addition, a panel of the Ninth Circuit, dealing with the special case[122] of a claim brought by an insolvent thrift against the FSLIC for having allegedly transferred its assets negligently to a buyer, has held that section 1464(d)(6)(C) strips the district courts of jurisdiction to hear the action.[123]

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[118] *See* Blakely Airport Joint Venture II v. FSLIC, 678 F. Supp. 154 (N.D. Tex. 1988); Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104 (D. Kan. 1988); Vernon Sav. & Loan Ass'n v. Homes Int'l Dev. Corp., 676 F. Supp. 247 (S.D. Fla. 1988); Resna Assocs. v. Financial Equity Mortgage Corp., 673 F. Supp. 1371 (D.N.J. 1987); FSLIC v. Florida 100 Dev. Group, 670 F. Supp. 1577 (S.D. Fla. 1987); York Bank & Trust Co. v. FSLIC, 663 F. Supp. 1100 (M.D. Pa. 1987), *vacated and remanded,* 851 F.2d 637 (3d Cir. 1988); Acquisition Corp. of Am. v. Sunrise Sav. & Loan Ass'n, 659 F. Supp. 138 (S.D. Fla. 1987); FSLIC v. Oldenburg, 658 F. Supp. 609 (D. Utah 1987); FSLIC v. Hall Whispertree Assocs., 653 F. Supp. 148 (N.D. Tex. 1986); Kohlbeck v. Kis, 651 F. Supp. 1233 (D. Mont. 1987); FSLIC v. Quality Inns, Inc., 650 F. Supp. 918 (D. Md. 1987); Baskes v. FSLIC, 649 F. Supp. 1358 (N.D. Ill. 1986); Baer v. Abel, 649 F. Supp. 25 (W.D. Wash. 1986); Baer v. Abel, 648 F. Supp. 69 (W.D. Wash. 1986); Colony First Fed. Sav. & Loan Ass'n v. FSLIC, 643 F. Supp. 410 (C.D. Cal. 1986); FSLIC v. Sajovich, 642 F. Supp. 74 (C.D. Cal. 1986); Sunrise Sav. & Loan Ass'n v. Lir Dev. Co., 641 F. Supp. 744 (S.D. Fla. 1986); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93 (W.D. Wash. 1986); Rembold v. Gibraltar Sav. & Loan Ass'n, 624 F. Supp. 1006 (W.D. Wash. 1985), *rev'd sub nom.* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); Murdock-SC Assocs. v. Beverly Hills Fed. Sav. & Loan Ass'n, 624 F. Supp. 948 (C.D. Cal. 1985), *aff'd in part and rev'd in part,* 815 F.2d 82 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Murdock-SC Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-452); Gibraltar Bldg. & Loan Ass'n v. State Sav. & Loan Ass'n, 607 F. Supp. 722 (N.D. Cal. 1985); *cf.* First Fin. Sav. & Loan v. FSLIC, 651 F. Supp. 1289 (E.D. Ark. 1987) (*Hudspeth* decision recognized but FSLIC held estopped from reconsidering merits of claims already determined in state court). Unreported decisions have been omitted to save space.

[119] *See* Modern Supply Co. v. FSLIC, 50 Wash. App. 194, 748 P.2d 251 (1987) (split decision); Keller v. Antioch Sav. & Loan Ass'n, 143 Ill. App. 3d 278, 492 N.E.2d 937 (1986); FSLIC v. Superior Court, 180 Cal. App. 3d 336, 225 Cal. Rptr. 422 (1986), *cert. denied,* 107 S. Ct. 949 (1987); Union County Bank v. Knox Capital Corp., No. C/A 657 (Tenn. Ct. App. Apr. 18, 1986) (Westlaw, 1986 WL 4598); *see also* FSLIC v. Kennedy, 732 S.W.2d 1 (Tex. Ct. App. 1986) (recognizing the general proposition enunciated in *Hudspeth,* but rejecting the argument that the FSLIC is entitled to redetermine the validity of claims that a court and jury have already adjudicated).

[120] *See* Red Fox Indus. v. FSLIC, 832 F.2d 340, 341-42 (5th Cir. 1987); Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563, 564 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988); FSLIC v. Bonfanti, 826 F.2d 1391, 1393-94 (5th Cir. 1987), *petition for cert. filed sub nom.* Zohdi v. FSLIC, 56 U.S.L.W. 3196 (U.S. Aug. 5, 1987) (No. 87-255); Chupik Corp. v. FSLIC, 790 F.2d 1269, 1270 (5th Cir. 1986); *see also* Godwin v. FSLIC, 806 F.2d 1290, 1292-94 (5th Cir. 1987) (affirming decision of district court to deny motion for reconsideration of order granting dismissal of depositors' claim that their deposit was insured). *But cf.* Northshore Dev. v. Lee, 835 F.2d 580 (5th Cir. 1988). In *Northshore,* the court held that when a judgment has already been entered prior to receivership, FSLIC can, on the basis of the *Hudspeth* doctrine, remove the action to federal court and have it dismissed. *Id.* at 593. The court, however, then noted that this does not imply that the district court must also vacate the judgment—FSLIC must choose between pursuing an appeal or securing dismissal and accepting the judgment. *Id.* (district court's denial of motion to vacate held not an abuse of discretion).

[121] Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 828 F.2d 387 (7th Cir. 1987); *see infra* note 134.

[122] *See infra* text accompanying notes 241-43.

2. Morrison-Knudsen: *No Statutory Authority.* After a year and a half of uncritical acceptance in federal courts, the *Hudspeth* doctrine received its first major setback at the hands of a panel of the Ninth Circuit in *Morrison-Knudsen Co. v. CHG International, Inc.*[124] The case involved an insolvent, federally chartered thrift, Westside Federal Savings and Loan Association (Westside), for which the FSLIC had been appointed receiver. Westside was involved in five pre-receivership claims[125] that the FSLIC, once it had been appointed Westside's receiver, sought to have dismissed by the respective adjudicating and supervising district courts. The FSLIC's motions in the first four claims had been granted on the basis of the *Hudspeth* doctrine, but the supervising court in the motion involving the fifth claim had denied the FSLIC's motion. The Ninth Circuit ruled that there was no appellate jurisdiction in two of the claims, but reversed the orders of dismissal in the other three.

The court was faced with challenges to both the FSLIC's statutory authority to adjudicate claims and its constitutional authority to do so given the provisions of article III of the United States Constitution.[126] It engaged in an extensive analysis of the statutory framework and legislative history of the FSLIC, its powers under sections 1464(d)(6)(C) and 1729(d), and the regulations promulgated by the FHLBB for processing claims in receiverships, and concluded that the legislation was not intended to confer adjudicatory powers on the receiver.[127] While acknowledging that the FSLIC has been vested with full receivership powers, the Court rejected the assumption in the second *Hudspeth* opinion that these included adjudication.

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[123] *See* Fidelity Fin. Corp. v. FSLIC, 834 F.2d 741 (9th Cir. 1987).

[124] 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451). The Ninth Circuit opinion was written by Judge Sneed, joined by Judges Kennedy and Beezer. For a criticism of *Morrison-Knudsen,* see Huber, *Enforcement Powers of Federal Banking Agencies,* 7 ANN. REV. BANKING L. 123, 160-61 (1988) (describing the case as "a decision for the home team").

[125] In the first claim it had been impleaded as a third-party defendant, having allegedly guaranteed repayment of a loan in default for which another thrift was being sued. In the second claim, a developer (CHG), to whom Westside had lent $6.5 million, had declared bankruptcy; a co-participant in a loan agreement sought declaratory orders against Westside regarding the validity of the agreement, as well as damages and an order quieting title. The third and fourth claims against Westside involved contractual damages and equitable relief arising out of the bankruptcy of CHG. The fifth claim was filed by Westside itself in CHG's bankruptcy proceedings. *Morrison-Knudsen,* 811 F.2d at 1213.

[126] *See infra* note 538 (quoting U.S. CONST. art. III, § 1 in full).

[127] *See* 811 F.2d at 1222.

> The rock upon which FSLIC's arguments break is that a receiver's ordinary functions do not include adjudication. Judicial adjudication . . . does not restrain or affect a receivership; it simply determines the existence and amount of claims that a receiver is to honor in its eventual distribution of assets.[128]

The court buttressed its statutory interpretation by addressing the constitutional challenge as well. While declining to go so far as to hold the FSLIC's assertions of adjudicatory jurisdiction to be in violation of article III, the court was not persuaded that "the powers [the FSLIC] seeks easily survive *Northern Pipeline* scrutiny."[129] This apprehension induced the court to read sections 1464(d)(6)(C) and 1729(d) so as to avoid the constitutional difficulty. Though the court recognized that Congress might, "with careful limitations like those governing FSLIC's adjudication of regulatory violations . . . have crafted an adjudicatory jurisdiction for FSLIC in its receivership capacity that would pass constitutional muster," it found itself "convinced" that Congress had "not attempted to do so."[130] In other words, the court, anticipating serious article III difficulties, read the statutory provisions upon which the FSLIC had relied narrowly and rejected the FSLIC's assertion that they conferred an adjudicatory jurisdiction.[131]

The strict interpretive approach of the Ninth Circuit has subsequently been followed in a number of federal and state courts[132] including, most recently, the Supreme Court of Texas.[133] On the other hand, *Morrison-Knudsen* has also been expressly rejected in favor of the *Hudspeth* doctrine by a number of other courts.[134]

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[128] *Id.* at 1217 (citing, as did the first *Hudspeth* opinion, Morris v. Jones, 329 U.S. 545 (1947)); *see supra* note 108.

[129] 811 F.2d at 1221 (referring to Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), in which the Court had ruled the bankruptcy court scheme established by the 1978 Bankruptcy Act to be a violation of article III); *see infra* text accompanying notes 545-59.

[130] 811 F.2d at 1222. Here the court was, in effect, merely applying the well-established principle that a statute should be construed, if possible, so as to save it from constitutional infirmities. *See, e.g.*, Morrison v. Olson, 108 S. Ct. 2597, 2614 (1988); Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 841 (1986).

[131] The court did, however, recognize that a creditor might be required to exhaust her administrative remedies, and the three claims were remanded for the district court to address this issue. In deciding whether to require the exhaustion of administrative remedies, the panel thought the trial court should consider whether: (i) resort to the administrative process would be futile; (ii) the administrative process was well-understood and well-developed; (iii) a prompt decision as to all of the contested issues in the case was likely; (iv) an exhaustion requirement would be fair to the parties in light of their resources; (v) it would be fair to other parties in the case whose interests might be affected; (vi) the interests of judicial economy would be served by requiring exhaustion; and (vii) the agency demonstrates that not requiring exhaustion would unduly interfere with its functioning. *See* 811 F.2d at 1223-24.

[132] *See, e.g.*, Murdock-SC Assocs. v. Beverly Hills Sav., 815 F.2d 82 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Murdock-SC Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-452); Homestead Sav. v. Life Sav. & Loan Ass'n, 668 F. Supp. 1121, 1124 (N.D. Ill. 1987) (opinion vacated and removed from bound volume, but appears in West's advance sheets, *see infra* text accompanying notes 738-39); FSLIC v. Provo Excelsior Ltd., 664 F. Supp. 1405, 1416 (D. Utah 1987); Summertree Venture III v. FSLIC, 742 S.W.2d 446, 453 (Tex. Ct. App. 1987); *cf.* FSLIC v. Frumenti Dev. Corp., 676 F. Supp. 957, 964 (N.D. Cal. 1988) (applying *Morrison-Knudsen* reason-

3. Glen Ridge: *A Violation of Article III.* Even if statutory authority to adjudicate does exist, neither the *Morrison-Knudsen* decision nor the decisions that have followed it have directly addressed the question whether such authority would be constitutional. The Constitution did, however, play a decisive role in the Texas court of appeals' decision in *Glen Ridge I Condominiums, Ltd. v. Federal Savings & Loan Insurance Corporation.*[135] The court, in two carefully reasoned opinions,[136] concluded that the FSLIC had been granted statutory authority to adjudicate claims and that such authority was a violation of article III. Although the Texas Supreme Court declined to reach the constitutional issue,[137] the court of appeals' decision is worth considering since it is the only one to date that has directly addressed underlying constitutional concerns.

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ing in remanding to a state court a claim involving only state-law rights and obligations, even though the FSLIC was a party); Peninsula Fed. Sav. & Loan Ass'n v. FSLIC, 663 F. Supp. 506, 509-11 (S.D. Fla. 1987) (distinguishing *Hudspeth* and partially applying principles enunciated in *Morrison-Knudsen* relating to exhaustion of remedies).

[133] *See* FSLIC v. Glen Ridge I Condominiums, 750 S.W.2d 757 (Tex. 1988) (per curiam), *aff'g on other grounds* 734 S.W.2d 374 (Tex. Ct. App. 1986). The decision of the court of appeals is discussed *infra* in text accompanying notes 135-40.

[134] The Seventh Circuit, in Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 828 F.2d 387, 391-95 (7th Cir. 1987), decided, in the absence of fuller argument, to follow *Hudspeth*. A number of district courts have expressly chosen *Hudspeth* over *Morrison-Knudsen*. *See, e.g.*, Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104, 1106 (D. Kan. 1988); Vernon Sav. & Loan Ass'n v. Homes Int'l Dev. Corp., 676 F. Supp. 247, 249 (S.D. Fla. 1988); Resna Assocs. v. Financial Equity Mortgage Corp., 673 F. Supp. 1371, 1377 (D.N.J. 1987); FSLIC v. Florida 100 Dev. Group, 670 F. Supp. 1577, 1580 (S.D. Fla. 1987); York Bank & Trust Co. v. FSLIC, 663 F. Supp. 1100 (M.D. Pa. 1987), *vacated and remanded*, 851 F.2d 637 (3d Cir. 1988); Acquisition Corp. of Am. v. Sunrise Sav. & Loan Ass'n, 659 F. Supp. 138, 140 (S.D. Fla. 1987); FSLIC v. Oldenburg, 658 F. Supp. 609, 611 (D. Utah 1987).

[135] 734 S.W.2d 374 (Tex. Ct. App. 1986), *aff'd on other grounds*, 750 S.W.2d 757 (Tex. 1988) (per curiam).

[136] In the court of appeals there were two motions for rehearings. The first was granted and the court withdrew its initial order affirming the trial court's dismissal of the claims against the FSLIC as receiver for Empire Savings and Loan. It reversed the judgment of the trial court and filed an opinion on December 30, 1986. Then, through a new panel in which only one of the original three judges remained, the court denied the second motion for rehearing and, on June 25, 1987, filed a supplemental opinion in support of its earlier decision, taking into account the opinions in Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986), the most recent Supreme Court decision on the application of article III to administrative agencies. *See infra* text accompanying notes 589-95.

[137] *See* FSLIC v. Glen Ridge I Condominiums, 750 S.W.2d at 758-59 (affirming the court of appeals' decision on the ground that statutory authority was lacking).

The Empire Savings and Loan Association (Empire) had partly financed real estate investment by Glen Ridge. When Empire went insolvent and the FSLIC was appointed its receiver, the FSLIC posted Glen Ridge's property for executive foreclosure pursuant to the relevant deeds of trust. Glen Ridge sued the FSLIC, Empire and the various trustees in state court for cancellation of the deeds of trust, damages, injunctive relief, and attorneys fees. Some claims were based on state law and others on federal law. The FSLIC, relying upon *Hudspeth,* had secured dismissal by the trial court of Glen Ridge's claims.

The court of appeals reversed the decision of the trial court insofar as the state-law claims were concerned, but affirmed the dismissal of the federal law claims.[138] Confining itself to the state-law claims, the Texas court went even further than the Ninth Circuit had done in *Morrison-Knudsen,* ruling that sections 1464(d)(6)(C) and 1729(d) did indeed purport to grant adjudicatory jurisdiction and that, insofar as this jurisdiction included state-law claims, it violated article III.[139] Motivating the court was the view that the adjudicatory scheme established by the FHLBB and the FSLIC fell far short of the criteria laid down by the United States Supreme Court for permissible departures from the literal provisions of article III.[140]

Prior to *Glen Ridge* a district court had rejected an article III challenge on the basis that "*Northern Pipeline* does not apply to administrative claims procedures,"[141] a conclusion that seems clearly wrong. The holding in *Glen Ridge* itself has apparently not yet been fully considered in subsequent decisions involving the FSLIC. The article III question has, however, been raised in a few other cases, including two currently pending before the Supreme Court.[142] In each case the lower courts have treated the article III issue as not yet ripe for decision.[143]

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[138] 734 S.W.2d at 387.

[139] *See id.* at 385-87.

[140] *See infra* text accompanying notes 568-73, 582, 590-95 (discussing these criteria).

[141] *See* Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 636 F. Supp. 576, 581-82 (N.D. Ill. 1986), *aff'd,* 828 F.2d 387 (7th Cir. 1987).

[142] *See* Thomes v. Equitable Sav. & Loan Ass'n, 837 F.2d 1317, 1318 (5th Cir. 1988); Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563, 564-65 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988); American Fed. Sav. & Loan Ass'n v. Westside Fed. Sav. & Loan Ass'n, No. C-85-323-C, slip op. (W.D. Wash. Feb. 4, 1986), *reprinted in* Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit at 38a, FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451) [hereinafter Stevenson Petition], *rev'd sub nom.* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. at 3249.

[143] In Thomes v. Equitable Sav. & Loan Ass'n, 831 F.2d 558 (5th Cir. 1987), a panel of the Fifth Circuit, while applying the *Hudspeth* doctrine insofar as the appellant's non-constitutional challenges were concerned, took note of the Ninth Circuit opinion in *Morrison-Knudsen* and as-

4. *Other Constitutional Issues.* Various other constitutional challenges to the FHLBB and FSLIC procedures have also been raised (unsuccessfully so far). Of the most important, it has been argued that the grant of adjudicatory power to the FSLIC constitutes a violation of the *nondelegation doctrine,*[144] that it violates the *seventh amendment* by denying the right to a jury trial,[145] and that it constitutes a violation of *due process,* either because it deprives the creditor-claimant of a constitutionally adequate hearing or because the FSLIC, as both receiver and insurer, has conflicting interests when adjudicating creditors' claims.[146]

In less important challenges, a litigant has contended that the effect of applying the FSLIC's argument, in this case so as to nullify a prior attachment order in the creditor's favor, constitutes an unconstitutional *taking* of a compensable property right,[147] and the question of *sovereign immunity* has been invoked several times, sometimes with success, by the FSLIC in order to buttress its assertion of exclusive jurisdiction to determine claims.[148] The takings and immunity questions will not be examined in this article.

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signed for oral argument the appellant's article III challenge to the FSLIC's exercise of adjudicatory jurisdiction. *See id.* at 559. But the court subsequently dismissed the constitutional challenges as unripe because the plaintiffs had not exhausted their administrative remedies. *Thomes,* 837 F.2d at 1318.

[144] *See* Baer v. Abel, 648 F. Supp. 69, 78 (W.D. Wash. 1986); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93, 100 (W.D. Wash. 1986); *American Fed. Sav. & Loan Ass'n,* No. C-85-323-C, slip op., *reprinted in* Stevenson Petition, *supra* note 142, at 49a-50; *see also infra* text accompanying notes 520-37.

[145] *See Coit Independence Joint Venture,* 829 F.2d at 565; *Baer,* 648 F. Supp. at 77-78; *see also infra* text accompanying notes 638-57.

[146] *See Coit Independence Joint Venture,* 829 F.2d at 564-65; FSLIC v. Florida 100 Dev. Group, 670 F. Supp 1577, 1583 (S.D. Fla 1987); *Baer,* 648 F. Supp. at 78; *First Am. Sav. Bank,* 639 F. Supp. at 100; Modern Supply Co. v. FSLIC, 50 Wash. App. 194, 205, 748 P.2d 251, 257-58 (1987); *see also infra* text accompanying notes 601-37.

[147] *See, e.g.,* FSLIC v. Superior Court, 180 Cal. App. 3d 336, 343, 225 Cal. Rptr. 422, 425-26 (1986) (issue not ripe for review), *cert. denied,* 107 S. Ct. 949 (1987).

[148] The contexts within which the claims of immunity have been made have varied, and the response of the courts has been mixed. *See, e.g.,* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1214-15, 1222-23 (9th Cir. 1987) (FSLIC's sovereign immunity held waived by 12 U.S.C. § 1729(b)(1)(B)), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); FSLIC v. Provo Excelsior Ltd., 664 F. Supp. 1405, 1417 (D. Utah 1987) (FSLIC's claim of adjudicatory power under 12 U.S.C. § 1729(d) rejected along with claim of sovereign immunity); Baer v. Abel, 649 F. Supp. 25, 26-27 (W.D. Wash. 1986) (court declared that it had no subject matter jurisdiction to hear counterclaims against FSLIC where FSLIC acted as receiver and defendants had not exhausted administrative remedies); *Baer,* 648 F. Supp. at 75-77 (FSLIC held immune from suit where FSLIC acted as receiver and plaintiffs did not bring claim in administrative forum); Colony First Fed. Sav. & Loan Ass'n v. FSLIC, 643 F. Supp. 410, 414-15, 417-18 (C.D. Cal. 1986) (FHLBB held immune from suit challenging its appointment of a conservator; claims against individual officers banned where they acted in their official capacities); *Modern Supply Co.,* 50 Wash. App. at 194, 748 P.2d at 251 (state court lacked jurisdiction over claim against FSLIC in its capacity as receiver); Summertree Venture III v. FSLIC, 742 S.W.2d 446,

II. The Liquidation Process

A. *Options for Dealing With Troubled Thrifts.*

1. *Sales and Financial Assistance.*[149] Thrifts are continuously monitored for safety and soundness by the examinations staff of the District Banks and the FHLBB's Office of Regulatory Policy, Oversight and Supervision. A primary concern is to try to prevent thrifts from failing in the first place; to this end the FSLIC has been granted extensive statutory powers to obviate outright receivership by lending assistance to troubled thrifts.[150]

When the FHLBB's Office of Regulatory Policy, Oversight and Supervision believes that a thrift is in imminent danger of default, it calls upon the FSLIC's Mergers and Acquisitions Division to determine if some method short of receivership can be devised to rehabilitate the thrift or dispose of it in a manner that would protect all the parties involved. The FSLIC can provide loans or contributions to the troubled thrift, acquire its assets or liabilities, financially assist its merger with another institution, consolidate it with others, or convert it from mutual to stock ownership in order to infuse it with new capital.[151] The FSLIC has also developed a Management Consignment Program, under which the thrift's management is replaced, pending the arrangement of a merger.[152]

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454 (Tex. Ct. App. 1987) (FSLIC not, in this instance, a court-appointed receiver, and enjoys no judicial immunity); Glen Ridge I Condominiums, Ltd. v. FSLIC, 734 S.W.2d 374, 384 (Tex. Ct. App. 1986) (case held not to involve automatically a "public right," thus justifying an administrative tribunal, simply because Congress waived FSLIC's immunity), *aff'd,* 750 S.W.2d 757 (Tex. 1988) (per curiam); *cf.* FHLBB v. Hague, 664 F. Supp. 245, 251 (W.D. La. 1987) (FSLIC and FHLBB enjoy sovereign immunity from suits sounding in tort and contract, and thus may not be sued directly), *aff'd,* 840 F.2d 14 (5th Cir. 1988); Kohlbeck v. Kis, 651 F. Supp. 1233, 1235 (D. Mont. 1987) (federal court jurisdiction over claims against FSLIC as receiver precluded until administrative procedure complete); *Colony First Fed. Sav. & Loan Ass'n,* 643 F. Supp. at 416-17 (dealing with immunity under Federal Tort Claims Act).

[149] *See generally* FHLB GUIDE, *supra* note 52, at 49-53; W. LOVETT, *supra* note 30, at 131-44; E. SYMONS & J. WHITE, *supra* note 40, at 600-03 (bank regulation context).

[150] *See* 12 U.S.C.A. § 1729(f) (West Supp. 1988).

[151] *See* FHLB GUIDE, *supra* note 52, at 49; Williams, *Thrift Acquisitions and Mergers: Statutory and Regulatory Framework and Current Issues,* in OFFICE OF LEGAL EDUC., U.S. DEP'T OF JUSTICE, FINANCIAL INSTITUTIONS SEMINAR 715, 981-93 (1987). As this article went to press, the FHLBB published guidelines regarding FSLIC's policy on financial assistance. *See* FSLIC Statement of Policy and Criteria on Assistance to Insured Institutions Absent a Requirement for an Immediate Merge Acquisition by a Third Party, 53 Fed. Reg. 30,714 (1988).

[152] The Management Consignment Program is designed to minimize the ultimate cost of rehabilitation, merger or liquidation by facilitating FSLIC intervention where a thrift's assets are being dissipated. *See* FHLB GUIDE, *supra* note 52, at 51-52; 1986 FHLBB ANN. REP. 28 (1987); Williams, *supra* note 151, at 985-86. The program has been criticized by some observers as ineffective. *See* Stevenson, *A Good Idea Gone Sour: Savings Talent on Loan,* N.Y. Times, June 8, 1988, at D1, col. 4, D9, col. 2 (city ed.).

2. *Receivership.* If it is not feasible to rehabilitate or merge the insolvent thrift, the FHLBB places the thrift into receivership, and appoints, as appropriate, either the FSLIC or FDIC as receiver.[153]

Because of the need to avoid loss of confidence in the thrift industry as a whole, large thrifts have tended to be treated more favorably than their smaller counterparts. An example is the highly publicized assistance given recently by the FSLIC to the American Savings and Loan Association.[154] Following the example of action taken the previous day by the FDIC to assist the subsidiary banks of the First Republicbank Corporation of Dallas,[155] and in order to prevent a crisis of public confidence, the FHLBB announced that all deposits in American, regardless of size, would be guaranteed by the FSLIC. The effect of such a measure is not only to provide unlimited deposit insurance[156] but also to keep open the doors of a thrift, thereby maintaining the ordinary legal rights of creditors. If the *Hudspeth* doctrine is valid, this means that the rights of creditors depend significantly on the decision whether to assist a thrift or place it into receivership.

3. *Federal Asset Disposition Association.* In the process of assisting or liquidating a troubled thrift, the FSLIC frequently takes over thrift assets with a view to managing and ultimately realizing them at their optimal value. To provide specialist attention to this function, the FHLBB chartered a private company, wholly owned by the FSLIC, in 1985. This is the Federal Asset Disposition Association, which has a ten-year charter.[157]

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[153] *See infra* text accompanying notes 166-75.

[154] *See* Nash, *U.S. Aids Financial Corp. Unit,* N.Y. Times, Mar. 19, 1988, at 17, col. 3 (national ed.).

[155] *See* Nash, *Large Texas Bank to get $1 Billion in Federal Rescue,* N.Y. Times, Mar. 18, 1988, at 1, col. 6 (national ed.).

[156] Deposit insurance is limited by statute to $100,000 per individual depositor. *See* 12 U.S.C. § 1724(b) (1982).

[157] *See* FHLB GUIDE, *supra* note 52, at 53-54; 1986 FHLBB ANN. REP. 29 (1987). The FADA, which Congress recently placed under the audit authority of the Comptroller General, *see* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 403, 101 Stat. 552, 609 (codified at 31 U.S.C.A. § 9105(a) (West Supp. 1988)), has been subjected to severe criticism for having failed to achieve its purposes and for becoming insolvent itself. The House Banking Committee has recommended its abolition. *See* H.R. 5094, 100th Cong., 2d Sess. § 703, *introduced,* 134 CONG. REC. H5887 (daily ed. July 26, 1988); H.R. REP. No. 822, 100th Cong., 2d Sess., pt. 1, at 143 (1988); STAFF OF HOUSE COMM. ON BANKING, FINANCE AND URBAN AFFAIRS, 100TH CONG., 2D SESS., FEDERAL ASSET DISPOSITION ASSOCIATION: REPORT OF AN INQUIRY INTO ITS OPERATIONS AND PERFORMANCE (Comm. Print), *reprinted in* 134 CONG. REC. H2203-06 (daily ed. Apr. 21, 1988).

B. *Placing Thrifts into Receivership.*

1. *The Agencies Involved.* When a thrift is federally insured, two of three federal agencies are involved in its supervision and receivership.[158] The FHLBB exercises overall regulatory control. The FSLIC, which is always under the direction of the FHLBB,[159] acts a receiver for the thrifts it insures. The FDIC, which is under the direction of the FHLBB when appointed the receiver of a federal thrift,[160] acts as receiver for federal savings banks.[161]

The three agencies deal with three categories of thrifts. First are federal thrifts: those savings and loan associations and savings banks chartered, or converted to federal charter, by the FHLBB under the Home Owners' Loan Act[162] and insured by either the FSLIC or the FDIC. Second are those state-chartered thrifts that are insured by the FSLIC subject to the direction of the FHLBB. Third are state-chartered savings banks, which can be insured by the FDIC without any FHLBB involvement.[163] Because the FDIC has only adopted the *Hudspeth* doctrine when it has been appointed receiver by the FHLBB,[164] this article will consider only receiverships involving the first two categories.

2. *Power to Appoint Receivers.*

a. Federally chartered thrifts. In the case of federally chartered thrifts, the FHLBB has exclusive authority under the Home Owners' Loan Act to appoint a receiver.[165] If the thrift is insured by the FSLIC, the FSLIC must be appointed receiver.[166] If, on the other hand, the thrift is a savings bank chartered under section 1464(o) and insured by the FDIC,[167] the FDIC must be appointed receiver.[168] Whereas the FHLBB has frequently appointed the FSLIC as a receiver, the FDIC has to date been appointed only once by the FHLBB.[169]

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[158] State-chartered savings banks are a narrow exception in that, even if insured by the FDIC, they are not subject to the regulation of the FHLBB.

[159] *See* 12 U.S.C. § 1725(a) (1982).

[160] *See infra* text accompanying notes 179-81.

[161] *See infra* text accompanying notes 167-69.

[162] *See* 12 U.S.C. § 1464(a) (1982).

[163] *See* 12 U.S.C. §§ 1813(a), 1815(a) (1982).

[164] *See infra* text accompanying notes 444-46.

[165] *See* 12 U.S.C. § 1464(d)(6)(A)-(B). The grounds for appointing a receiver (or conservator) are one or more of the following:

> (i) insolvency in that the assets of the association are less than its obligations to its creditors and others, including its members; (ii) substantial dissipation of assets or earnings due to any violation or violations of law, rules, or regulations, or to any unsafe or unsound practice or practices; (iii) an unsafe or unsound conditions [sic] to transact business; (iv) willfull violation of a cease-and-desist order which has become final; (v) concealment of books, papers, records, or assets of the association or refusal to submit books, papers, records, or affairs of the association for inspection to any examiner or to any lawful agent of the Board[;] . . .
>
> . . . [or] in the event that (i) the association, by resolution of its board of directors or of its members, consents to such appointment, or (ii) the association is removed from membership in any Federal home loan bank, or its status as an institution the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation is terminated.

Id.

b. State-chartered thrifts. In the case of state-chartered thrifts that are insured by the FSLIC, the FHLBB has exclusive authority under the National Housing Act to appoint the FSLIC as receiver if the thrift is in a state of insolvency, if it is losing assets due to violations of law or unsafe or unsound practices, or if it is in an unsafe or unsound condition to transact business.[170] The FSLIC then has all the receivership powers it enjoys as a receiver for a federal thrift.[171]

If, on the other hand, a *state* decides to place a state-chartered thrift into receivership and that thrift is insured by the FSLIC, the FSLIC *may* be appointed receiver by the state authority; if so, it possesses the same powers as those it enjoys as a federal receiver.[172] The FHLBB will then "federalize" the receivership and assume supervisory control of the FSLIC as receiver.[173] The legislation also leaves open the possibility that the state authority could place a thrift into receivership and *not* appoint the FSLIC as receiver,[174] though in most cases the FHLBB would in any event be entitled to federalize the receivership and appoint the FSLIC.[175]

c. Exclusivity of the FHLBB's power of appointment and removal. The Home Owners' Loan Act authorizes the Board to appoint receivers without notice,[176] but the association is entitled to challenge this appointment in a federal district court within thirty days.[177] Subject to this exception, section 1464(d)(6)(C) provides that

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[166] *See* 12 U.S.C. §§ 1464(d)(6)(D), 1729(b)(1) (1982).

[167] The FDIC is required to insure the accounts of federal savings banks. *See* 12 U.S.C. § 1726(a)(1) (1982).

[168] *See* 12 U.S.C. §§ 1464(d)(6)(D), 1821(c) (1982).

[169] Telephone interview with Judith L. Friedman, Associate General Counsel, FHLBB (Mar. 21, 1988); *see* 52 Fed. Reg. 49,204 (1987) (appointing the FDIC as receiver for Yankee Bank for Finance and Savings, FSB).

[170] *See* 12 U.S.C. §§ 1729(c)(1)(B), 1464(d)(6)(A)(i)-(iii).

[171] *See* 12 U.S.C. § 1729(c)(1)(B)(i)(II).

[172] *See* 12 U.S.C. § 1729(c)(1)(A).

[173] *See* 12 U.S.C. § 1729(c)(1)(B)-(c)(2); *see also* Fidelity Sav. & Loan Ass'n v. FHLBB, 689 F.2d 803, 808-09 (9th Cir. 1982) (statutory requirements were satisfied for appointment of the FSLIC as federal receiver), *cert. denied,* 461 U.S. 914 (1983).

[174] *See* 12 U.S.C. § 1729(c)(1). If the thrift is federally insured but the FSLIC is *not* appointed receiver, the FSLIC is required to pay the insurance and is entitled "(1) to bid for the assets of the insured institution in default, (2) negotiate for the merger of the insured institution or the transfer of its assets, or (3) make any other disposition of the matter as it may deem in the best interests of all concerned." *Id.*

[175] *See* 12 U.S.C. § 1729(c)(2).

[176] *See* 12 U.S.C. § 1464(d)(6)(A)-(B).

> no court may take any action for or toward the removal of any conservator or receiver, or, except at the instance of the Board, restrain or affect the exercise of powers or functions of a conservator or receiver.[178]

3. *Powers Upon Appointment.*

a. Powers conferred by statute. When the FHLBB was given regulatory responsibility over federal savings banks, the insuring and receivership role of the FDIC was retained. This created the possible anomaly that thrift receiverships might be governed, depending on which agency was appointed receiver, by two separate pieces of legislation: if the FSLIC were appointed, the National Housing Act would apply; if the FDIC were appointed, the Federal Deposit Insurance Act would apply. The FHLBB's rules relating to federal receiverships purport, however, to apply to both the FSLIC and the FDIC,[179] and there is statutory language to support this view.[180] Hence the powers of both the FSLIC and the FDIC acting under the supervision of the FHLBB will be treated as being the same.[181] In any event, the general receivership practices of the FDIC are sufficiently similar to those of the FSLIC for present purposes to permit focus upon the FSLIC.[182]

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[177] *See* 12 U.S.C. § 1464(d)(6)(A).

[178] 12 U.S.C. § 1464(d)(6)(C); *see infra* text accompanying notes 394-403.

[179] *See* 12 C.F.R. § 549.1(b) (1988); *cf.* Conservators and Receivers, 50 Fed. Reg. 48,970, 48,973 (proposed Nov. 8, 1985) (to be codified at 12 C.F.R. § 549.2) (extending the application of the FHLBB's *Hudspeth* procedures to the FDIC).

[180] The receivership power (to buy at its own sale) conferred upon the FSLIC as receiver by 12 U.S.C. § 1464(d)(6)(D) is expressly stated to be applicable to the FDIC as receiver of a closed savings bank. And the powers conferred upon the FSLIC as receiver in 12 U.S.C. § 1729(b) are stated to be applicable to federal savings banks as well. *Id.*

[181] In the only receivership in which it has been appointed by the FHLBB, *see supra* note 169, the FDIC has successfully secured the dismissal of at least one creditor's complaint from a federal district court on the basis of *Hudspeth* principles. *See* Rivers v. Yankee Bank for Fin. & Sav., FSB, No. 88-0004-C (S.D. Ala. Mar. 21, 1988) (Westlaw, 1988 WL 81615) (single-page memorandum decision). On the other hand, a Massachusetts district court, in a fully reasoned opinion, has subsequently refused to recognize the FDIC's and FHLBB's claims to exclusive jurisdiction and has in effect rejected the *Hudspeth* doctrine for FDIC savings bank receiverships. *See* Tocci Corp. v. Yankee Bank for Fin. & Sav., FSB, No. 87-3121-K (D. Mass. May 25, 1988) (Westlaw, 1988 WL 70344).

[182] On FDIC receiverships, see generally FDIC, THE FIRST FIFTY YEARS: A HISTORY OF THE FDIC 1933-1983 ch. 5 (1984); E. SYMONS & J. WHITE, *supra* note 40, at 600-707; Skillern, *Federal Deposit Insurance Corporation and the Failed Bank: The Past Decade* (pts. 1 & 2), 99 BANKING L.J. 233, 292 (1982); Note, *Failing Banks: Creditors' Rights and the Distribution of Bank Assets*, 7 AM. REV. BANKING L. 325 (1988); Comment, *Bank Failure and the FDIC: A Survey of Legal Rights and Relationships of the Client and the Insolvent Bank*, 18 TEX. TECH L. REV. 1193 (1987); Note, *The Modified Payoff of Failed Banks: A Settlement Practice to Inject Market Discipline into the Commercial Banking System*, 73 VA. L. REV. 1349 (1987); Note, *Creditors' Remedies Against the*

Under the National Housing Act, when the FSLIC is appointed as the receiver of a thrift, it is authorized as receiver

> (i) to take over the assets of and operate such association;
> (ii) to take such action as may be necessary to put it in a sound solvent condition;
> (iii) to merge it with another insured institution;
> (iv) to organize a new Federal association to take over its assets;
> (v) to proceed to liquidate its assets in an orderly manner; or
> (vi) to make such other disposition of the matter as it deems appropriate; whichever it deems to be in the best interest of the association, its savers, and the [FSLIC] . . . .[183]

In addition, the receiver "shall pay all valid credit obligations of the association."[184]

Section 1729 supplements these powers and duties by granting a wide range of powers to the FSLIC to contract, form new federal thrifts, and lend financial and managerial assistance to existing ones.[185] Subsection 1729(d) also provides that:

> [i]n connection with the liquidation of insured institutions, the [FSLIC] shall have power to carry on the business of and to collect all obligations to the insured institutions, to settle, compromise, or release claims in favor of or against the insured institutions, and to do all other things that may be necessary in connection therewith, subject only to the regulation of the Federal Home Loan Bank Board, or, in cases where the [FSLIC] has been appointed conservator, receiver, or legal custodian solely by a public authority having jurisdiction over the matter other than said Board, subject only to the regulation of such public authority.[186]

FDIC as Receiver of a Failed National Bank, 64 TEX. L. REV. 1429 (1986). For differences between the powers of the FDIC and the FSLIC, see *infra* text accompanying notes 447-52.

[183] 12 U.S.C. § 1729(b)(1)(A). The legislation formerly required the FSLIC to act in the best interest of the "insured members of the association in default." National Housing Act of 1934, ch. 847, § 406(b), 48 Stat. 1246, 1260. The amendment was contained in the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 122(b), 96 Stat. 1469, 1481.

[184] 12 U.S.C. § 1729(b)(1)(B).

[185] *See* 12 U.S.C.A. § 1729(a), (f) (West 1980 & Supp. 1988).

[186] 12 U.S.C. § 1729(d) (1982). The original section 1729(d) was amended in 1982 by the Garn-St Germain Depository Institutions Act, Pub. L. No. 97-320, § 122(g), 96 Stat. at 1482-83. Section 1729(d) had previously read:

> In connection with the liquidation of insured institutions in default, the [FSLIC] shall have power to carry on the business of and to collect all obligations to the insured institutions, to settle, compromise, or release claims in favor of or against the insured institutions, and to do all other things that may be necessary in connection therewith, subject only to the regulation of the court or other public authority having jurisdiction over the matter.

National Housing Act, ch. 847, § 406(d), 48 Stat. at 1260. The Garn-St Germain Act therefore substituted a new final clause emphasizing the exclusive regulatory authority of the FHLBB when the FHLBB appoints the FSLIC as the receiver of a state thrift. The amendment was subject to an automatic sunset that came into effect on October 13, 1986, but it was restored in August 1987 by the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 509(a), 101 Stat. 552, 635 (1987). Whether the amendment makes any difference for our purposes is doubtful. Indeed, prior to *b. The Board's regulatory powers.* The Home Owners' Loan Act also grants to the FHLBB a general power to regulate the conduct of receiverships:

> The Board shall have power to make rules and regulations for the reorganization, consolidation, liquidation, and dissolution of associations, for the merger of associations with associations or with any institutions the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, for associations in conservatorship and receivership, and for the conduct of conservatorships and receiverships; and the Board may, by regulation or otherwise, provide for the exercise of functions by members, directors, or officers of an association during conservatorship or receivership.[187]

The FHLBB has promulgated rules under this section, including the rules governing the *Hudspeth* process.[188]

4. *Strategies Developed by the FSLIC.*[189] When it has been determined that a receivership is necessary, responsibility for the troubled thrift shifts to the Insurance Division of the FSLIC. A team from the Division, acting on a written order of seizure of the FHLBB, moves to seize the institution in question.[190] The operation is performed secretly and quickly in order to avoid public panic or last-minute maneuvering by the thrift's management to improve their own financial positions. The senior management is relieved of its duties immediately, the institution's doors are sealed, and the Insurance Division arranges a direct or indirect payout to insured depositors.

To conserve the insurance fund, the FSLIC tries to avoid a direct payout and liquidation wherever possible. In most cases it now uses its powers under section 1729(b)(1)(A)[191] to arrange "purchase and assumption transactions":[192] either a simple transfer of insured accounts to an-

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the Garn-St Germain Act, section 1729(c)(3) had stated that "[i]n connection with the liquidation of any [state-chartered] institution, the language 'the court or other public authority having jurisdiction over the matter' in subsection (d) of this section shall mean the said Board." Bank Protection Act of 1968, Pub. L. No. 90-389, § 6, 82 Stat. 294, 296, *repealed by* Garn-St Germain Depository Institutions Act, Pub. L. No. 97-320, § 122, 96 Stat. at 1482; *see* Summertree Venture III v. FSLIC, 742 S.W.2d 446, 449 n.1 (Tex. Ct. App. 1987) (determination of which version of section 1729(d) applies is inconsequential); *see also infra* text accompanying notes 415-19.

[187] 12 U.S.C. § 1464(d)(11); *see infra* text accompanying notes 404-06.

[188] *See infra* text accompanying notes 203-05.

[189] *See generally* FHLB GUIDE, *supra* note 52, at 52-53; Pfeiler, *supra* note 54, at 441-42 (discussing the FSLIC's adoption of "comprehensive administrative procedure for handling receiverships"); Williams, *supra* note 151, at 981-1002 (reviewing FSLIC techniques for resolving supervisory acquisitions and mergers).

[190] *See* FHLB GUIDE, *supra* note 52, at 52.

[191] *See supra* text accompanying note 183.

[192] Though a well-established practice, *see, e.g.*, 12 C.F.R. § 569a.13 (1988), purchase and assumption transactions were first fully addressed and defined only in 1985, by the FHLBB's proposed rules relating to conservatorships and receiverships, *see infra* note 201.

other institution (which will have bid for these at a slight premium), or an asset-backed transfer of accounts to a newly created mutual thrift.[193] Where the transferee assumes all the liabilities of the failed thrift, the problem of processing the claims of creditors disappears since creditors continue to enjoy their ordinary rights against the transferee institution.[194] If some of the liabilities of the thrift in receivership are not transferred, however, the creditors will retain only a right of claim against the FSLIC as receiver for the failed thrift.[195] Hence it is only where the FSLIC decides on a direct payout and liquidation, or on a *partial* purchase and assumption transaction, that the claims of creditors require resolution, and it is in this context that we turn to examine the administrative process devised by the FHLBB for handling these claims.

5. *Claims Procedures.* Claims against failed thrifts are institutionally and procedurally separated at the FSLIC.[196] Those made by in-

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[193] In 1986, for example, 8 of the 10 completed liquidations involved transfers of accounts rather than direct payouts. 1986 FHLBB ANN. REP. 27 table 5 (1987).

[194] *See, e.g.*, Bean v. Independent Am. Sav. Ass'n, 838 F.2d 739 (5th Cir. 1988). In *Bean*, a panel of the Fifth Circuit, per Judge Higginbotham (who wrote the opinion in *Hudspeth*), refused to extend the *Hudspeth* doctrine to creditors whose claims have been assumed by a new thrift. "[B]y transferring a liability or asset the FSLIC has determined that claims related to it should not be switched to the administrative track . . . ." *Id.* at 743.

[195] When this happens, the remaining creditors are prejudiced in that they have to share in a distribution from a balance of assets that is, by virtue of the insolvency of the thrift, likely to be insufficient to meet their claims in full. *See* Pfeiler, *supra* note 54, at 442. Whether this preference is either authorized or fair is an open question.

Here, as in the initial decision whether to lend a thrift financial assistance or place it in receivership, *see supra* text accompanying notes 149-56, the decision is crucial to the rights of creditors.

The question of fairness to general creditors is also raised by the FHLBB's recent creation of an express depositor priority in certain purchase and assumption transactions and in the payment of claims from proceeds of certain thrift liquidations. The FHLBB has recognized the general principle that the claims of general creditors should rank equally with those of insured depositors. *See* Conservators and Receivers; Priority of Claims, 53 Fed. Reg. 25,129, 25,133 (1988) (to be codified at 12 C.F.R. § 569c.11(a)(6)). In the case of state-chartered thrifts chartered in states that have themselves enacted depositor-priority legislation, however, and in the case of claims against federally chartered thrifts that are competing with depositor claims booked or registered in states with such legislation, the FHLBB has now established its own depositor-priority system. *See* Conservators and Receivers; Priority of Claims; Depositor Priority, 53 Fed. Reg. 30,665, 30,667-68 (1988) (to be codified at 12 C.F.R. § 569c.11(a)(6)). Given the parlous state of many insolvent thrifts, this new priority is likely in effect to extinguish general creditor claims altogether. *See, e.g.*, FHLBB Resolution No. 88-378P (May 18, 1988) (appointment of receiver for Lamar Savings Association, Austin, Texas) (finding "the Association's general creditors' claims . . . worthless" after applying the available proceeds to the satisfaction of the Association's secured and deposit liabilities). Not only does this action severely stretch the FHLBB's asserted statutory authority, but it also seems to cast further doubt on the agency's ability to act as a genuinely impartial adjudicator in the case of claims filed by general creditors.

[196] Whereas it is governed by the FHLBB's *Hudspeth* procedures when processing the claims of uninsured creditors, the FDIC applies its own procedures in determining and paying the claims of insured depositors. *Cf.* Conservators and Receivers, 50 Fed. Reg. 48,992 (to be codified at 12 C.F.R.

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sured depositors are handled by the Insurance Division of the Office of the FSLIC (OFSLIC),[197] and claims involving uninsured depositors and other creditors are processed by FSLIC as receiver of the failed institution in question, functioning through the FSLIC's Operations and Liquidations Division (with the assistance of a division of the Office of General Counsel). FSLIC Corporate would then itself become a claimant against the thrift in receivership (FSLIC Receiver).[198]

Though the procedures for processing the claims of insured depositors are fairly well-developed and well-codified,[199] the procedures for processing uninsured and general creditor claims are still highly informal and in a state of development. This is partly because the increase in the range of creditor claims and the number of outright liquidations are fairly recent developments,[200] and partly because judicial approval in *Hudspeth* for the administrative adjudication process came only in 1985. Late in 1985 the FHLBB published a set of proposed rules codifying the *Hudspeth* procedures,[201] but these have not yet been converted into final rules.[202] At present the procedures for processing claims are governed by an earlier set of rules,[203] supplemented by a set of unpublished guidelines,[204] which were formerly made available to individual claimants by

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§ 569c.7(b)(4)) (proposed Nov. 8, 1985) (exempting the FDIC from the application of FHLBB rules governing the processing of depositor claims). *See generally* 12 U.S.C. § 1821 (1982).

[197] *See* 12 C.F.R. § 500.20(a) (1988).

[198] To avoid confusing these two capacities, the discussion will distinguish "FSLIC Corporate" and "FSLIC Receiver."

[199] *See generally* 12 C.F.R. pt. 564 (1988).

[200] *See supra* text accompanying notes 52-88.

[201] Conservators and Receivers: Proposed Rule, 50 Fed. Reg. 48,970 (to be codified at 12 C.F.R. pts. 547, 548, 549, 563, 569a, 569b, 569c) (proposed Nov. 8, 1985).

[202] The FHLBB recently gave notice that proposed rules published by it and upon which no action has been taken by the Board will automatically lapse after six months. Regulatory Review Procedures, 53 Fed. Reg. 13,156 (1988). The expiration date for the Board's 1985 proposed *Hudspeth* rules was, however, extended to October 11, 1988. *See* Extension of Time Period for Board Action on Certain Outstanding Proposals, 53 Fed. Reg. 13,282 (1988).

Meanwhile, agency staff are currently preparing a further, shortened notice of proposed rulemaking for consideration by the Board. Telephone interview with Judith L. Friedman, Associate General Counsel, FHLBB (May 2, 1988). The Board has subsequently published a Supplemental Notice of Proposed Rulemaking, *see* Federal Savings and Loan Insurance Corporation; Receivers, 53 Fed. Reg. 21,474 (to be codified at 12 C.F.R. pts. 575, 576, 577) (proposed May 26, 1988), which incorporates the modifications made to informal procedures that have been in effect since July 1, 1986. As this article was going to press, the Board apparently was planning to publish final rules that would conform with those published in the supplemental notice.

[203] *See* 12 C.F.R. pts. 549, 569a (1988) (addressing federal thrift receiverships and state thrift receiverships). Section 549 applies to both the FSLIC and the FDIC. *See id.* § 549.1(b).

[204] *See* Instructions for Filing Claims with the FSLIC as Receiver (Feb. 12, 1987) (FHLBB internal memorandum); Procedures for the Administration and Determination of Claims Filed with the FSLIC as Receiver (Feb. 12, 1987) (FHLBB internal memorandum); Procedures for the Processing and Determination of Administrative Appeals from Decisions of the FSLIC as Receiver (July 3, 1986) (FHLBB internal memorandum); Procedures for the Administration and Determination of

receivers and which have now been published in modified form as "Interim Procedures" and as revised proposed rules.[205]

C. *Depositor Claims.*

When an insured institution fails and the institution is placed in receivership, FSLIC Corporate is required to pay each insured account as soon as possible, either in cash or by means of a transferred account.[206] In practice, depositors' claims, whether insured or not, are processed by the Insurance Division, OFSLIC. Depositors, to the extent that their claims are uninsured, receive certificates of claims in liquidation, copies of which are then provided directly to the FSLIC Receiver by the Insurance Division.[207]

1. *Notice to Potential Claimants.* Upon default of the insured institution, the FSLIC gives written notice to all insured members of the time and place of insurance payments and, if the failed institution has outstanding debts in the form of negotiable instruments, it must promptly publish a similar notice in a local newspaper.[208] Insurance claims are processed by the staff of the Insurance Division.[209]

2. *Initial Determinations.* The FSLIC may require proof of claims and, where not satisfied as to the claim's validity, may require the insured member to secure a final determination of the claim in a court of competent jurisdiction.[210] The general principles governing the Director's determination as to the validity of a claim to insured status are codified.[211] For those claims accepted as valid and insured, the FSLIC must

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Requests for Expedited Relief from Decisions or Threatened Actions of the FSLIC as Receiver (Mar. 1987) (FHLBB internal memorandum). The latter three sets of guidelines are reprinted in Pfeiler, *supra* note 54, apps. C-E, at 490-510.

[205] *See* Conservators and Receivers; Interim Procedures, 53 Fed. Reg. 13,105 (1988). These consist of: Procedures for the Administration and Determination of Claims Filed with the FSLIC as Receiver, 53 Fed. Reg. at 13,105-10 [hereinafter Claims Procedures]; Procedures for the Processing and Determination on Review of Determinations of the FSLIC as Receiver, *id.* at 13,110-12 [hereinafter Review Procedures]; Procedures for the Administration and Determination of Requests for Expedited Relief from Decisions or Threatened Actions of the FSLIC as Receiver, *id.* at 13,112-13 [hereinafter Expedited Relief Procedures]. The interim procedures have since been incorporated in Federal Savings and Loan Insurance Corporation; Receivers, 53 Fed. Reg. at 21,474-82 (to be codified at 12 C.F.R. §§ 575.1-577.5). *See id.* at 21,475 (to be codified at 12 C.F.R. § 575.1).

[206] *See* 12 U.S.C. § 1728(b) (1982); *see also* 12 U.S.C.A. § 1729(b)(2) (West Supp. 1988) (obligating the FSLIC as receiver to pay the "*insurance* as provided in section 1728" (emphasis added)).

[207] *See* 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.6); Claims Procedures, *supra* note 205, at 13,107 (para. II (D)).

[208] 12 C.F.R. § 564.1(a) (1988).

[209] 12 C.F.R. § 564.1(d) ("[t]he Director or Acting Director . . . or his or her designee").

[210] *See* 12 U.S.C. § 1728(b).

[211] 12 C.F.R. § 564.2.

either pay out in cash[212] or transfer the account of the insured member to another insured institution.[213]

If all or a portion of the accountholder's account is determined to be uninsured, the Director must give written notice of this determination and supply the accountholder with a "certificate of claim in liquidation" from the FSLIC "in its capacity as receiver." This enables the accountholder to share in the proceeds of the liquidation of the insured institution.[214]

3. *Insurance Appeals ("Reconsiderations").* A dissatisfied accountholder may request reconsideration of the determination.[215] Failure to do so is deemed acceptance of the initial determination.[216] In practice, insurance reconsiderations are adjudicated by a member of the Adjudication Division of the Office of General Counsel.[217]

If the procedural requirements are complied with, the Director must grant or deny the request[218] and, within a further 180 days, must issue a decision on the merits of the reconsideration (a "determination on reconsideration").[219] If a determination on reconsideration is not issued within this time the request for reconsideration is deemed to have been denied.[220]

Since the handling of these requests was taken over by the Adjudication Division, the reversal rate stands at 8.2%.[221]

4. *Judicial Review.* Actions must be brought within three years of the date of default or, if the claim was presented to the receiver and

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[212] 12 U.S.C. § 1728(b).

[213] That institution may either be one newly created in the same community, or an existing one. *Id.*

[214] 12 C.F.R. § 564.1(d)(2). The surrender and transfer to the FSLIC of an insured account

> shall subrogate the Corporation with respect to such insured account, but shall not affect any right which the insured member may have in the uninsured portion of his account or any right which he may have to participate in the distribution of the net proceeds remaining from the disposition of the assets of such association.

12 U.S.C.A. § 1729(b)(2) (West Supp. 1988).

[215] 12 C.F.R. § 564.1(d)(3).

[216] *Id.* §§ 564.1(d)(2), (d)(3)(iv).

[217] This responsibility was transferred from the Regulations and Legislation Division of OGC, effective November 1, 1986. *See* Adjudication Division: Processing of Initial Insurance Determination Reconsideration Requests (undated FHLBB internal memorandum).

[218] *See* 12 C.F.R. § 564.1(d)(3)(ii)(*c*).

[219] *Id.* § 564.1(d)(4).

[220] *Id.*

[221] That is, 34 cases of a total of 414, involving decisions in favor of claimants to a total value of $1,848,353. Telephone interview, *supra* note 202.

denied, within two years of the date of denial.[222] According to the Board's rules, an accountholder must exhaust the remedies already described; an initial determination for which the accountholder does not request reconsideration is taken to have been accepted,[223] so failure to request reconsideration in a timely fashion will effectively prevent the holder from seeking review.[224]

D. *Uninsured and Nondepositor Claims: The* Hudspeth *Process.*

1. *Types of Claims Involved.* The FHLBB's *Hudspeth* procedures are intended to encompass all types of claims that might be made against the thrift in receivership, with the exception of claims by insured depositors.[225] Under the FHLBB's interim and proposed rules, a "claim" is defined as "the assertion of a right to payment or other relief" and includes demands for recoupment, setoff, security, priority, or preference, requests to foreclose or oppose foreclosure by the receiver on security property or assets, demands for interest, employee wages, etc.[226] "Claimants" include, "but [are] not limited to," holders of claims that appear in the thrift's books or records, or otherwise are known to the Receiver, owners of participation interests, borrowers, guarantors, secured creditors, lien holders and "[a]ny person(s) or entities seeking to recover civil money damages or equitable relief against the association or the Receiver."[227]

This encompasses a breathtaking range and variety of claims. In order to appreciate the comprehensive coverage of the *Hudspeth* procedures and the potential complexity of the claims involved, it is worth reviewing some of the of the types of claims that have been asserted in recent cases.

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[222] 12 U.S.C. § 1728(c). As to the applicability of the *Hudspeth* doctrine to the claims of insured depositors, see *infra* text accompanying notes 390-91.

[223] 12 C.F.R. § 564.1(d)(2).

[224] *Id.* § 564.1(d)(5). In Jugum v. FSLIC, 637 F. Supp. 1045, 1047 (W.D. Wash. 1986), this limitation was rejected as invalid. *See infra* note 390 (discussing *Jugum,* which has been vacated as moot).

[225] *See* Federal Savings and Loan Insurance Corporation; Receivers, 53 Fed. Reg. 21,474, 21,476 (to be codified at 12 C.F.R. § 575.6(a)) (proposed May 26, 1988); Claims Procedures, *supra* note 205, at 13,107 (para. II(D)). Depositors with other claims are also claimants for the purposes of the rules. *See* 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.6 (c)); Claims Procedures, *supra* note 205, at 13,107 (para. II(D)).

[226] *See* 53 Fed. Reg. at 21,475 (to be codified at 12 C.F.R. § 575.2(h)); Claims Procedures, *supra* note 205, at 13,106 (para. I(B)(9)).

[227] *See* 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.2(h)(3)); Claims Procedures, *supra* note 205, at 13,106 (para. I(B)(10)). Secured creditors and owners of participation interests might enjoy some exemption from the published procedures. *See* 53 Fed. Reg. at 21,475 (to be codified at 12 C.F.R. § 575.1); Supplementary Information, 53 Fed. Reg. at 13,105.

a. Claims filed prior to receivership. Prior to being placed in receivership, a thrift might have initiated litigation against a former officer with a view to repudiating claims being made against it for the continued payment of deferred compensation.[228] Or it might have launched foreclosure proceedings against one of its mortgage holders.[229] The thrift might have found itself embroiled with other thrifts in litigation involving a participatory loan agreement, litigation that could involve claims of breach of contractual or other obligations[230] and perhaps even charges of securities fraud and racketeering,[231] antitrust violations,[232] or race discrimination.[233]

b. Claims adjudicated prior to receivership. The validity of a creditor's claim might already have been judicially determined, yet the claim might still be unpaid. A plaintiff might have secured an as yet unexecuted judgment against the thrift.[234] The parties might have entered into and already partly implemented a judicially supervised settlement agreement.[235]

c. Postreceivership litigation. When the FSLIC or the FDIC is appointed receiver, the FSLIC Receiver steps into the shoes of the thrift itself. The situation can then become even more complex. The receiver will not only inherit the thrift's pre-existing litigation responsibilities but might also generate new ones. For example the FSLIC Corporate might find itself repudiating and defending claims by *depositors* to the payment of insurance.[236] Or, as receiver, it might reject claims filed by *general creditors*, arising out of prior action by the failed thrift, and then have to defend a suit, or multiple suits, based on contract, tort or some other cause of action.[237]

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[228] *See, e.g.*, *Hudspeth, supra* note 103, 756 F.2d at 1096; *see also supra* text accompanying notes 98-117.

[229] *See, e.g.*, FirstSouth, F.A. v. LaSalle Nat'l Bank, No. 86 C 10247 (N.D. Ill. Sept. 7, 1987) (Westlaw, 1987 WL 16895).

[230] *See, e.g.*, Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563 (5th Cir. 1987) (claims of usury, breach of fiduciary duty, and breach of duty of good faith and fair dealing), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988).

[231] *See, e.g.*, Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 828 F.2d 387 (7th Cir. 1987).

[232] *See, e.g.*, Red Fox Indus. v. FSLIC, 832 F.2d 340, 341 (5th Cir. 1987).

[233] *See, e.g.*, Resna Assocs. v. Financial Equity Mortgage Corp., 673 F. Supp. 1371 (D.N.J. 1987).

[234] *See, e.g.*, Homestead Sav. v. Life Sav. & Loan Ass'n, 668 F. Supp. 1121 (N.D. Ill. 1987) (jury verdict for creditor of $6.2 million, already paid over to clerk of court " 'in full satisfaction of the judgment' " prior to thrift being placed in receivership) (opinion vacated and removed from bound volume, but appears in West's advance sheets, *see infra* text accompanying notes 738-39); First Fin. Sav. & Loan v. FSLIC, 651 F. Supp. 1289 (E.D. Ark. 1987) (letter opinion entered by state court judge but judgment order not yet signed; FSLIC held estopped from litigating claims); FSLIC v. Kennedy, 732 S.W.2d 1 (Tex. Ct. App. 1986) (affirming judgment entered in favor of creditor against thrift for recovery of certificate of deposit originally pledged as collateral in loan transaction subsequently breached by thrift); Union County Bank v. Knox Capital Corp., C/A657 (Tenn. Ct. App. Apr. 18, 1986) (Westlaw, 1986 WL 4598) (decree in favor of plaintiff issued prior to receivership of defendant; judgment entered after receivership but nunc pro tunc to date of opinion).

[235] *See, e.g.*, FSLIC v. Bonfanti, 826 F.2d 1391 (5th Cir. 1987), *petition for cert. filed sub nom.* Zohdi v. FSLIC, 56 U.S.L.W. 3196 (U.S. Aug. 5, 1987) (No. 87-255).

The FSLIC Receiver might have to initiate or pursue litigation—for example, foreclosure proceedings, actions to recover receivership assets, or petitions to enjoin thrift directors from dissipating recoverable assets—as part of the liquidation proceedings.[238] It might have to file claims, on behalf of the receivership, in other bankruptcy proceedings.[239] Finally, the possibility of the FSLIC or the FDIC suing "itself" in two separate receivership capacities is not confined to the realm of the classroom hypothetical.[240]

d. Claims against the exercise of receivership powers. The FSLIC might even be sued in tort for the manner in which it has conducted the receivership.[241] In these circumstances one should bear in mind that the exercise of the FSLIC's *statutory powers* are under challenge and not the validity of creditor claims against the thrift itself. The Federal Tort Claims Act[242] and questions of sovereign immunity become relevant.[243]

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[236] *See, e.g.*, York Bank & Trust Co. v. FSLIC, 663 F. Supp. 1100 (M.D. Pa. 1987), *vacated and remanded*, 851 F.2d 637 (3d Cir. 1988); Kohlbeck v. Kis, 651 F. Supp. 1233 (D. Mont. 1987); Baskes v. FSLIC, 649 F. Supp. 1358 (N.D. Ill. 1986).

[237] *See, e.g.*, FSLIC v. Provo Excelsior Ltd., 664 F. Supp. 1405 (D. Utah 1987) (multiple parties; securities fraud, federal and state RICO); Acquisition Corp. of Am. v. Sunrise Sav. & Loan Ass'n, 659 F. Supp. 138 (S.D. Fla. 1987) (multiple parties; fraud and deceit, state RICO, breach of contract, civil theft); *Kohlbeck*, 651 F. Supp. at 1233 (negligence, fraud and racketeering); FSLIC v. Quality Inns, Inc., 650 F. Supp. 918 (D. Md. 1987) (counterclaim based on unjust enrichment and conversion of assets); Keller v. Antioch Sav. & Loan Ass'n, 143 Ill. App. 3d 278, 492 N.E.2d 937 (1986) (false representation, breach of contract).

[238] *See, e.g.*, FSLIC v. Dixon, 835 F.2d 554 (5th Cir. 1987) (preliminary injunction to prevent dissipation of possibly recoverable assets by directors); FSLIC v. Ticktin, 832 F.2d 1438 (7th Cir. 1987) (action against thrift directors for breach of fiduciary duties); Red Fox Indus. v. FSLIC, 832 F.2d 340 (5th Cir. 1987) (action by borrower to enjoin collection of debt by thrift and subsequent receiver); Blakely Airport Joint Venture II v. FSLIC, 678 F. Supp. 154 (N.D. Tex. 1988) (foreclosure); FSLIC v. Florida 100 Dev. Group, 670 F. Supp. 1577 (S.D. Fla. 1987) (foreclosure); FSLIC v. Hall Whispertree Assocs., 653 F. Supp. 148 (N.D. Tex. 1986) (foreclosure); FSLIC v. Oldenburg, 658 F. Supp. 609 (D. Utah 1987) (complaint by assignment of rights from lead lender); FSLIC v. Quality Inns, Inc., 650 F. Supp. 918 (D. Md. 1987) (action for recovery of receivership assets); Baer v. Abel, 649 F. Supp. 25 (W.D. Wash. 1986) (FSLIC intervention as plaintiff, asserting claims against former thrift officers for negligence, breach of fiduciary duty of care, breach of contract, violation of federal regulations, recovery of compensation, and contribution or indemnification); FSLIC v. Sajovich, 642 F. Supp. 74 (C.D. Cal. 1986) (action brought by FSLIC as conservator against thrift directors and independent corporations for breach of fiduciary duty, negligence, and money had and received); Glen Ridge I Condominiums, Ltd., v. FSLIC, 734 S.W.2d 374 (Tex. Ct. App. 1986) (foreclosure), *writ denied*, 750 S.W.2d 757 (Tex. 1988) (per curiam).

[239] *See, e.g.*, *In re* Miller Dev. Corp., 71 Bankr. 460 (Bankr. M.D. La. 1987).

[240] *See* FDIC v. United States Nat'l Bank, 685 F.2d 270, 271 (9th Cir. 1981) (FDIC, as receiver for lending bank, brought action against itself as receiver for borrowing bank); *see also* Skillern, *Federal Deposit Insurance Corporation and the Failed Bank: The Past Decade* (pt. 2), 99 BANKING L.J. 292, 325 (1982) (discussing case in which bank that had failed and was placed under FDIC receivership sued another FDIC receivership).

2. *Structures and Procedures Developed by the FHLBB.*

a. Internal receivership arrangements. When the FHLBB resolves to appoint the FSLIC as receiver, the Director, OFSLIC,[244] with the concurrence of the General Counsel,[245] designates a "Special Representative" to bear primary responsibility for the administration of the claims procedure, conduct the claims procedure, and determine the merits of claims.[246] The Special Representative may then designate "Agents" "to perform certain functions, which include but are not limited to maintaining a tracking system of the claims filed with the Receiver and performing an initial review of the Proofs of Claim submitted to the Receiver."[247] The Special Representative, with the consent of the General Counsel, will also designate legal counsel, known as "Claims Counsel," "to represent the Receiver . . . [and] to perform specified tasks" (set out in the Claims Procedures).[248]

In practice,[249] the United States has been divided into five receivership regions: the Northwest, West, South, Central and East. Each of these regions has a "Claims Coordinator" who manages the claims for receiverships within that region. Claims Coordinators are nonlawyer auxiliaries who provide administrative services to the Special Representatives and who bill each receivership for their time. In order to avoid premature agreement on payouts to creditors, they are presently required to be assisted by Claims Counsel from the moment a thrift is seized. In addition, the lead attorney from the Adjudication Division of the FHLBB's Office of General Counsel meets with Claims Counsel immediately prior to the takeover in order to explain the procedures and ensure the proper implementation of the claims process. The lead attorney remains available for consultation throughout the takeover process and is frequently available on site. In order to minimize conflicts of interest, Division attorneys are instructed not to discuss the particulars of any transaction that might give rise to a claim against the receivership and to absent themselves from any debriefing of the thrift officers by Claims Counsel and the FSLIC.

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[241] *See, e.g.*, Fidelity Fin. Corp. v. FSLIC, 834 F.2d 741 (9th Cir. 1987) (First Savings and Loan Association, which had been placed into receivership, brought action in state court against FSLIC, which had been appointed as receiver, challenging the transfer of assets); Kohlbeck v. Kis, 651 F. Supp. 1233 (D. Mont. 1987); Colony First Fed. Sav. & Loan Ass'n v. FSLIC, 643 F. Supp. 410 (C.D. Cal. 1986) (FSLIC sued for damages it allegedly caused when thrift was placed in receivership); *Glen Ridge I Condominiums*, 734 S.W.2d at 387 (debtor of failed thrift brought action to enjoin FSLIC, as receiver of failed thrift, from foreclosing on its property).

[242] Title IV, 28 U.S.C. §§ 2671-2680 (1982) (current sections include minor amendments to original title IV).

[243] For cases in which the FSLIC has attempted to argue that it enjoys sovereign immunity insofar as ordinary creditor claims are concerned, see *supra* note 148.

[244] *See* 12 C.F.R. § 500.20 (1988). This structure is currently undergoing reorganization: the position formerly held by the Director, OFSLIC, will be held by an Executive Director of the FSLIC. Telephone interview, *supra* note 202.

[245] *See* 12 C.F.R. § 500.17. This may be an attorney in the Office of General Counsel designated by the General Counsel. *See* 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.2(q)); Claims Procedures, *supra* note 205, at 13,107 (para. I(B)(18)).

[246] *See* 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.2(z)); Claims Procedures, *supra* note 205, at 13,107 (para. I(B)(26)).

[247] *See* 53 Fed. Reg. at 21,475 (to be codified at 12 C.F.R. § 575.2(c)); Claims Procedures, *supra* note 205, at 13,106 (para. I(B)(4)).

[248] *See* 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.2(j)); Claims Procedures, *supra* note 205, at 13,107 (para. I(B)(11)); *see also* 12 C.F.R. § 549.3(b)(1) (1988) (receiver may employ any attorney(s) for legal advice and assistance).

[249] The information that follows was obtained during an interview with Judith L. Friedman, Director of the Adjudication Division of the Office of General Counsel, FHLBB, on October 21, 1987, and from internal FHLBB memoranda that Ms. Friedman made available to the author.

It is common for a team of Special Representatives to be appointed for each receivership. The team is headed by a Chief Special Representative, who is also referred to as the "Managing Officer." This officer internally reviews and supervises the initial determination of claims, though the degree of centralization varies from region to region. For example, the Southern region is very centralized, whereas the Western region is very decentralized. Special Representatives need not be lawyers, and in practice usually are not.

It is important to appreciate the informal, non-adversary and administrative quality of the claims determination process at the receivership level. Even Claims Counsel play the role of often confidential legal advisers to the Claims Coordinators and Special Representatives. They are private, fee counsel, occupying no formal adjudicative position in the receivership. It is also important to note that the FHLBB does not now regard the receiver, or any of its officers, as performing an "adjudicative" role at the initial claims determination phase; rather, the claims determination process assumes an adjudicative posture only at the administrative "review" stage.[250]

b. Notice to potential claimants. Promptly after the date of appointment, the receiver must publish a notice directing all potential claimants to present their claims promptly.[251] In the notice a final date for the filing of proof of claims must be stipulated.[252]

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[250] *See infra* note 275.

[251] *See* 12 C.F.R. § 549.4(a); 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.3); Claims Procedures, *supra* note 205, at 13,107 (para. II(A)). Claimants must be provided at least 90

c. Determinations by the receiver. The regulations require the receiver "[t]o allow any claim seasonably received and proved to its satisfaction."[253]

The interim Claims Procedures make provision for an "initial review" of claims.[254] This review is performed by claims agents who enter the claims in a control log[255] and review them for proper filing.[256] If a claim is not properly filed the claimant must be sent a "deficiency notice"[257] and be given an opportunity to correct the deficiencies.[258] Once this has been done the claim is reviewed on the merits[259] and the claimant must be notified whether the claim has been allowed or retained for further review.[260]

If the claim is "retained for further review," the Special Representative will decide, according to the "nature of the task," the "issues involved in the claim" and, "where no significant legal issue is presented, the cost-savings involved," whether to assign reviewing responsibilities to an Agent, an Agent acting under the direction of a Claims Counsel, and/or to a Claims Counsel.[261]

When conducting further review of the claim, the Special Representative may require the claimant to file additional information or documentation, make nonprivileged documents available for inspection and

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days from the date of first publication of notice to present their claims, and the notice must be republished 30 and 60 days after first publication. *See* 12 C.F.R. § 549.4(a) (1988); 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. §§ 575.4, 575.5); Claims Procedures, *supra* note 205, at 13,107 (paras. II(B), (C)).

[252] 12 C.F.R. § 549.4(a) (1988); 53 Fed. Reg. at 21,476 (to be codified at 12 C.F.R. § 575.4); Claims Procedures, *supra* note 205, at 13,107 (para. II(B)). This date must not be less than 90 days after the date of the first notice.

[253] 12 C.F.R. § 549.4(b).

[254] *See* 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. §§ 575.7-575.11); Claims Procedures, *supra* note 205, at 13,107-08 (paras. III(A)-(E)).

[255] *See* 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.8); Claims Procedures, *supra* note 205, at 13,107 (para. III(B)).

[256] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.9); Claims Procedures, *supra* note 205, at 13,107-08 (para. III(C)).

[257] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.9(a)); Claims Procedures, *supra* note 205, at 13,108 (para. III(C)(1)).

[258] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.9(a), (b)); Claims Procedures, *supra* note 205, at 13,108 (paras. III(C)(1), (2)).

[259] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. §§ 575.9(d), 575.10); Claims Procedures, *supra* note 205, at 13,108 (paras. III(C)(4), (D)).

[260] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.11); Claims Procedures, *supra* note 205, at 13,108 (para. III(E)).

[261] 53 Fed. Reg. at 21,477 (to be codified at 12 C.F.R. § 575.12(b)); Claims Procedures, *supra* note 205, at 13,108 (para. IV(A)(2)).

copying, and file sworn responses to written questions.[262] He may also review "documents or other written information relevant to the claim in the custody of or subject to the control of any person or entity, including the writing from any persons including the claimant or his employees, and may obtain sworn statements . . . ."[263] These form part of the administrative record[264] and, to the extent that they are not privileged, may be inspected and copied by the claimant.[265] The Special Representative may grant requests by the claimant to appear before an Agent, may require such an appearance, or may require the claimant to give statements, discuss the claim, and negotiate, subject to the Special Representative's approval, compromises of the claim.[266] The claimant's oral statements must be reduced to writing, sworn to, and made part of the administrative record, but statements by both parties during settlement negotiations do not constitute part of the receiver's record.[267] The Special Representative may require the claimant to submit a written legal memorandum on the issues; in such cases, this memorandum also becomes part of the record.[268] An indexed record must then be compiled and made available to the claimant for inspection and copying.[269]

Claims Counsel then consults with the Special Representative in order to provide "confidential, privileged legal advice as may be necessary to assist the Special Representative to reach a proposed determination with respect to the claim."[270] The Special Representative must then prepare a memorandum of proposed findings of fact and conclusions of law, an analysis of the issues and a recommended proposed determination (proposed determination memorandum), as well as a proposed determination of claim in the form of proposed findings of fact and conclusions of law (proposed determination). Claims Counsel assists in this process, but any proposed determination memorandum he prepares that is superseded does not constitute part of the record.[271] The proposed determination is then mailed to the claimant[272] and, if no request for reconsideration is filed, it becomes the "receiver's determination."[273]

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[262] *See* 53 Fed. Reg. at 21,477-78 (to be codified at 12 C.F.R. § 575.13(b)); Claims Procedures, *supra* note 205, at 13,108 (para. IV(B)(2)).

[263] 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(c)); Claims Procedures, *supra* note 205, at 13,108 (para. IV(B)(3)).

[264] *Id.*

[265] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(d)); Claims Procedures, *supra* note 205, at 13,108-09 (para. IV(B)(4)).

[266] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(e), (f)); Claims Procedures, *supra* note 205, at 13,109 (paras. IV(B)(5), (6)).

[267] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(f)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(6)).

[268] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(g)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(7)).

[269] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(i), (j)); Claims Procedures, *supra* note 205, at 13,109 (paras. IV(B)(9), (10)).

[270] *See* 53 Fed. Reg. at 21,478 (to be codified at 12 C.F.R. § 575.13(k)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(11)).

The proposed determination must advise the claimant of his right to file (within thirty days) a written "request for reconsideration." Such request must state the grounds of objection and may present proposed alternative findings and conclusions. The Special Representative must then promptly reply in writing, stating agreement or partial or complete disagreement. The request and reply become part of the administrative record.[274] After consideration of the record, the receiver must issue a "receiver's determination,"[275] signed by the Special Representative,[276] and a "record of claim" stating the amount of the claim recognized.[277]

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[271] *See* 53 Fed. Reg. at 21,478-79 (to be codified at 12 C.F.R. § 575.13(*l*),(m)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(12)).

[272] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(n)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(13)).

[273] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(*o*)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(14)) (formerly "initial determination").

[274] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(p)(5)); Claims Procedures, *supra* note 205, at 13,110 (para. IV(B)(15)(e)).

[275] Formerly known as a "final determination." The term "final determination" came to be regarded as a misnomer because it suggested greater formality in the claims determination by the receiver than is really the case in practice. The alternative term, "receiver's determination," is thought to convey the nature of the receiver's decision more accurately. Interview with Judith L. Friedman, Associate General Counsel, FHLBB, in Washington, D.C. (Oct. 21, 1987).

[276] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(d)); Claims Procedures, *supra* note 205, at 13,110 (para. IV(B)(15)(f)).

[277] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(s)); Claims Procedures, *supra* note 205, at 13,110 (para. IV(B)(18)).

There is no rigid limit on the permitted time lapse between a creditor's initial filing of a claim and the determination by the receiver. The stipulated (and unstipulated) time limitations are as follows:

Action	Days	To Be Codified at
Deficiency notice	30	12 C.F.R. § 575.9(a)
Notice of allowance or retention	180	*Id.* § 575.11
Further review:		
• Further filing	30	*Id.* § 575.13(b)(1)
• Written response	30	*Id.* § 575.13(b)(3)
• Response to request	30	*Id.* § 575.13(g)
• Additional documents	30	*Id.* § 575.13(j)
• Receiver's memorandum	"prompt"	*Id.* § 575.13(*l*)
• Request for reconsideration	30	*Id.* § 575.13(p)
• Special representative's reply	"prompt"	*Id.* § 575.13(p)(4)
• Determination	?	*Id.* § 575.13(p)(6)

Assuming that where maximum times are not specified the receiver's agents comply within 30 days, the total time lapse might be as long as *15 months*. It appears that some determinations are taking even longer. *See infra* text accompanying notes 722-28. The interim and proposed rules permit a claimant to request expedited processing of a claim, but such processing is available only upon a showing of good cause, and even after such a showing, expedited processing remains a matter "in the sole discretion of the Receiver." *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.14); Claims Procedures, *supra* note 205, at 13,110 (para. IV(C)).

d. Administrative reviews. The FHLBB regulations contemplate "approval" by the Board of claims disallowed by the receiver.[278] Interim provisions for "reviews" (formerly referred to as "appeals") of decisions of the receiver have been established.[279] Though formally directed to the Board, the authority to hear these appeals has been delegated by the Board to the Director, OFSLIC,[280] who has, in turn, subdelegated the authority to the Director of the Adjudication Division of the Office of General Counsel.[281] Review determinations recommending the reversal, in whole or in part, of decisions by the receiver on the merits disallowing claims in excess of $5 million must, however, be submitted to the Board itself for final determination,[282] and the Adjudication Division will, in practice, submit other determinations to the Board that it believes merit the Board's personal attention.[283]

When, on reconsideration, a receiver's determination has been issued,[284] or if the claimant does not request reconsideration,[285] the claimant is entitled to—and must, in order to preserve the right to judicial review—seek review of the determination by the Bank Board.[286] Notice of the right to seek review must be given to the claimant with the proposed determination by the receiver.[287]

Written notice of a request for review must be filed with the Board within sixty days,[288] and the request must contain a statement of the facts and arguments on which the request is based, a statement of the alleged factual and legal errors, references to the record and statement of any new facts upon which the request is based.[289] Unless more information is required,[290] the request will be subjected to a "preliminary review" within 60 days.[291] Further evidence may only be introduced on a showing of good cause.[292]

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[278] *See* 12 C.F.R. § 549.4(b), (d) (1988).

[279] *See* 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576); Review Procedures, *supra* note 205, at 13,110-12 (paras. A-L).

[280] FHLBB, Resolution No. 86-1161 (Nov. 17, 1986).

[281] Delegation of Authority from the Director, Office of the Federal Savings and Loan Insurance Corporation to the Associate General Counsel for Adjudication to Perform Routine Procedural and Ministerial Functions Respecting the Implementation of Interim Claims Procedures. (Jan. 15, 1987) [hereinafter Delegation of Authority].

[282] FHLBB, Resolution No. 86-1161, *supra* note 280.

[283] Interview, *supra* note 275.

[284] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(q)); Claims Procedures, *supra* note 205, at 13,110 (para. IV(B)(16)).

[285] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(*o*)); Claims Procedures, *supra* note 205, at 13,109 (para. IV(B)(14)).

[286] In practice, extensive legal support is provided to the Board by the General Counsel and the Director of the Adjudication Division. *See supra* text accompanying note 281.

[287] *See* 53 Fed. Reg. at 21,479 (to be codified at 12 C.F.R. § 575.13(q)); Claims Procedures, *supra* note 205, at 13,110 (para. IV(B)(16); 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.2); Review Procedures, *supra* note 205, at 13,111 (para. B(1)).

[288] *See* 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.3(a)); Review Procedures, *supra* note 205, at 13,111 (para. C(1)).

The record is then reviewed to determine whether it constitutes a sufficient basis for decision. If so, notice is given that the record is complete, and the record is closed.[293] Within 180 days of closure of the record a decision on the merits of the review will be issued by the Board.[294]

e. Board review. In more complex cases, the Board, on the advice or request of the General Counsel, and "in its sole discretion," "may entertain oral argument, or other supplementary proceedings."[295] Failure on the part of the Board to take such action, or failure to make a decision within the 180-day period, renders the receiver's determination the "decision of the Board." The Board will provide a written decision accompanied by its reasons[296] and, to the extent that the claim is recognized, will provide the claimant with a "satisfaction of claim certificate."[297]

f. Judicial review. The Board's decision or inaction constitutes final agency action for the purpose of judicial review.[298] The Review Procedures purport to be a mandatory prerequisite to the availability of judicial review.[299]

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[289] *See* 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.4(a)); Review Procedures, *supra* note 205, at 13,111 (para. D).

[290] If so, more time may be required. *See* 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.4(b)(2), (3)); Review Procedures, *supra* note 205, at 13,111 (para. D(2)).

[291] *See* 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.4(b)); Review Procedures, *supra* note 205, at 13,111 (para. D(2)).

[292] 53 Fed. Reg. at 12,481 (to be codified at 12 C.F.R. § 576.5(b)); Review Procedures, *supra* note 205, at 13,111 (para. E).

[293] *See* 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.5(a)); Review Procedures, *supra* note 205, at 13,111 (para. E(4)). The Board, however, reserves the right to "make its own findings of fact and conclusions of law based on the Administrative Record." 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.5(e)).

[294] 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.7); Review Procedures, *supra* note 205, at 13,111 (para. G(1)). The decision is given in the name of the Board.

[295] 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.7); Review Procedures, *supra* note 205, at 13,111 (para. G). This must be done within 30 days of closure of the record, in which case the 180-day period is suspended until the supplementary proceedings are complete.

[296] *See* 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.8); Review Procedures, *supra* note 205, at 13,111 (para. H).

[297] *See* 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 576.11); Review Procedures, *supra* note 205, at 13,112 (para. K).

[298] *See* 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. §§ 576.8, 576.9, 576.11(b)); Review Procedures, *supra* note 205, at 13,111-12 (paras. H, I, K(2)).

3. *"Expedited Relief."* Entirely independent of the claims procedures just described are the provisions for expedited relief from decisions or threatened actions of the receiver.[300] This procedure is designed to enable the FHLBB, through its delegate, to grant appropriate forms of equitable relief. Since its inception the remedy has expanded into a form of general injunctive relief available and applicable to both claimants and to the receiver itself (most frequently for correcting procedural irregularities).[301] In practice requests for expedited relief are adjudicated, as in the case of creditor appeals and insurance appeals, by the Director of the Adjudication Division, under subdelegation from the Director, OFSLIC.[302]

Any person affected by "[a]ny decision or threatened action by the FSLIC as Receiver" may seek "extraordinary intervention by the Board outside of the routine claims process" by filing a "request for expedited relief."[303] An example of such a situation would be threatened foreclosure.[304] The rules state that a request for expedited relief does not involve the merits of any claim and is solely a request to the Board to intercede on behalf of the petitioner.[305]

The request must contain a statement of the facts and issues, alleged factual and legal errors or omissions made by the receiver, legal analysis, relevant documentation, an assessment of the likelihood of success on the merits of the underlying claim, and a statement of the probable imminent and irreparable harm that would occur if relief were not granted. Notice of the request must be given simultaneously to the receiver.[306]

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[299] 53 Fed. Reg. at 21,480 (to be codified at 12 C.F.R. § 576.3(g)); Review Procedures, *supra* note 205, at 13,111 (para. C(7)).

[300] *See* 53 Fed. Reg. at 21,481-82 (to be codified at 12 C.F.R. § 577); Expedited Relief Procedures, *supra* note 205, at 13,112-13.

[301] Interview, *supra* note 275; *see also* Pfeiler, *supra* note 54, at 446-47.

[302] Delegation of Authority, *supra* note 281.

[303] *See* 53 Fed. Reg. at 21,481 (to be codified at 12 C.F.R. § 577.2(b)); Expedited Relief Procedures, *supra* note 205, at 13,112 (para. A(2)). This must be done "within five work days from the date of the Receiver's decision or action." The Board may extend the time limits for any expedited relief proceedings. *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.5); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. D).

[304] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.5)); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. D).

[305] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.3(a)); Expedited Relief Procedures, *supra* note 205, at 13,112 (para. B(1)).

[306] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. §§ 577.2(e), 577.3(a)(7)); Expedited Relief Procedures, *supra* note 205, at 13,112 (paras. A(5), B(1)(vii)).

The receiver must file a response within five days[307] and this response, together with the request and accompanying documentation, forms the basis for the administrative record on which the Board will make its determination.[308] Any additional information required by the Board must be supplied "by a date certain."[309] The Board will issue a temporary restraining order, if necessary, instructing the receiver to stay its threatened action pending resolution of the request for expedited relief.[310]

The Board then issues a final decision with reasons, "as soon as practicable."[311]

E. *Overview of the Adjudicatory Structure.*

The overall picture that emerges is as follows:

- At the primary decisionmaking level there is one agency, acting in two separate institutional capacities. For determinations involving insured deposits, the Insurance Division of FSLIC Corporate is responsible. For determinations involving uninsured deposits and general creditor claims, an agent of the FSLIC Receiver is responsible.
- At the Board level, the Director of the Adjudication Division of the FHLBB is in practice responsible for adjudicating disputes over both insurance and other claims, with the possibility of direct review and oral hearings by the Board.
- Finally, according to the *Hudspeth* doctrine, the determinations of the Board, with the possible exception of those involving insured depositor claims,[312] are subject to limited judicial review under the APA.

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[307] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.3(b)); Expedited Relief Procedures, *supra* note 205, at 13,112 (para. B(2)).

[308] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.3(c)); Expedited Relief Procedures, *supra* note 205, at 13,112 (para. C(5)).

[309] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.4(e)); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. C(5)).

[310] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.4(g)); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. C(7)). The stay will remain in effect "for a period of time sufficient to enable the party requesting relief to be provided with the Bank Board's Decision and an opportunity to seek judicial review of that Decision." *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.4(g)); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. C(7)).

[311] *See* 53 Fed. Reg. at 21,482 (to be codified at 12 C.F.R. § 577.4(d)); Expedited Relief Procedures, *supra* note 205, at 13,113 (para. C(4)).

[312] The courts are divided on the question whether insured depositors are entitled to full, de novo judicial review or only *Hudspeth*, APA-type review. *See infra* note 390 and accompanying text.

III. CONSTRAINTS UPON AGENCY ADJUDICATION

In order to provide a framework for evaluating the general *Hudspeth* procedures, it is necessary to review the statutory, constitutional and administrative law constraints within which the FHLBB must operate. Though not always recognized, these constraints share a subtle interdependency. For example, where questions of constitutionality do not arise, it is enough that an agency's authority to act be merely implied in its governing legislation.[313] But where the exercise of its powers appears to encroach upon the prescriptions of article III, it may be necessary for the agency's authority to be stated in fairly explicit terms.[314] Second, a broad delegation of agency authority, which might once have been regarded as unconstitutional,[315] will be accepted if there are adequate procedural safeguards in, and judicial scrutiny of, the exercise of that authority.[316] Third, the courts might be more willing to tolerate agency authority that encroaches upon the preserve of article III if the exercise of that authority is subjected to the standards of due process[317] and if there is adequate judicial scrutiny of the agency's action.[318] Yet adequate judicial scrutiny might mandate the observance by the agency of stricter procedural standards than might ordinarily be required, either by the APA or by the requirements of procedural due process.[319] And the application of the due process requirement of an impartial decisionmaker will vary according to the internal structural arrangements of the agency.[320] Finally, if the courts are satisfied that Congress has not violated article III in allocating decisionmaking power to an agency, they are also likely to accept that the seventh amendment requirement of a jury trial is inappropriate in the context of agency adjudication.[321]

This interdependency suggests that Congress and the FHLBB, in devising a claims adjudication system, must take account of a whole network of statutory and constitutional restraints, none of which should be seen in isolation from the others. At the same time, the Board has the advantage of being able to secure a system of adjudication during a period in which the Supreme Court has been extraordinarily deferential toward agencies. In the field of statutory interpretation, the Court has initiated an era of deference toward the construction by agencies of their congressional mandates.[322] In considering the role of agencies within the constitutional framework, it has settled upon an ad hoc balancing test for determining whether constitutional constraints have been breached.[323] And in considering the application of the APA, it has been reluctant to enforce directly the observance of procedural standards beyond those expressly stipulated in the Act.[324]

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[313] *See infra* text accompanying notes 325-36.

[314] *See infra* text accompanying notes 596-98.

[315] *See infra* note 514.

[316] *See infra* text accompanying notes 533-36.

[317] *See infra* text accompanying notes 560, 573.

[318] *See infra* text accompanying notes 555, 573.

[319] *See infra* text accompanying notes 681-84.

[320] *See infra* text accompanying notes 617-37.

[321] *See infra* text accompanying notes 638-52.

A. *Legislative Constraints: The Authority to Adjudicate.*

1. *Statutory Interpretation in Modern Administrative Law.* In 1984 the Supreme Court, in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,[325] firmly indicated that courts were to defer to the construction by agencies of their statutory mandates whenever those mandates were not expressed in clear terms. Justice Stevens enunciated a two-stage test:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[326]

In determining whether the FSLIC and the FHLBB possess statutory authority to adjudicate creditor claims, the *Chevron* analysis dictates that we should first ask whether the relevant legislation clearly addresses the issue. If this is the case then the inquiry is answered automatically and the adjudication power either exists or does not. If, on the other hand, the legislation is "silent or ambiguous," then we should defer to the agencies' view, provided this is "based on a permissible construction of the statute."

The trouble is that this two-stage test is deceptively simplistic and it should come as no surprise that subsequent application by the Court itself of the *Chevron* analysis has generated confusion and controversy.[327] It is not immediately obvious how we might determine whether "the intent of Congress is clear." Will this depend upon whether Congress has expressed itself in "plain" and "unambiguous" language?[328] Or will it depend upon whether, applying the traditional principles of statutory construction, the meaning of otherwise unclear language becomes "clear"?[329] If the words are "clear," must the court's analysis be confined to the "purely linguistic level,"[330] or can one resort to legislative history in order to demonstrate that ostensibly clear words are in fact unclear, so that one should defer to the agency that has chosen to disregard them?[331] As one commentator has recently observed, "one judge's plain meaning may be another's ambiguity."[332]

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[322] *See infra* text accompanying notes 325-36.

[323] *See infra* text accompanying notes 510-18.

[324] *See infra* text accompanying notes 489-92.

[325] 467 U.S. 837 (1984).

[326] 467 U.S. at 842-43 (footnotes omitted).

The *Hudspeth* court relied on *Chevron* in accepting the FHLBB's construction of the FSLIC's powers under the Home Owners' Loan Act and the National Housing Act.[333] But *Chevron* has probably failed to simplify the task of identifying whether statutory authority for administrative claims adjudication exists or even whether the assumption that it does is a "permissible" construction of the legislation. The decision is better understood for present purposes as merely signaling a general, perhaps even necessary,[334] disposition of deference toward agencies under circumstances in which there is no reason to mistrust their judgment.[335] The courts have proven accommodating in allowing significant reinterpretations of banking regulatory statutes (though not always in favor of the agencies) as the appropriateness of the legislation has changed over time.[336] Hence, though we still need to examine the origin and evolution of the statutory provisions upon which the FHLBB and the FSLIC rely for their asserted jurisdiction, we should also bear in mind that statutory construction will be influenced by the fact that the courts are likely to display a benevolent attitude toward the banking agencies in their current difficulties.

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[327] *See* Hochberg, *'Two-Step' Method of Analysis: Still in Transition After* Chevron, Nat'l L.J., May 16, 1988, at 22, col. 1. *But see* Pierce, Chevron *and its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 Vand. L. Rev. 301, 302 (1988) (*Chevron* amounts to simple approach in complicated area); Starr, *Judicial Review in the Post-*Chevron *Era*, 3 Yale J. on Reg. 283, 283-84 (1986) (*Chevron* eliminated ambiguity in Clean Air Act Amendments of 1977); Starr, Sunstein, Willard, Morrison & Levin, *Judicial Review of Administrative Action in a Conservative Era*, 39 Admin. L. Rev. 353, 360 (1987) (*Chevron* provides clear, analytical framework for analysis); Note, *Judicial Review of the Federal Banking Regulatory Agencies*, 7 Ann. Rev. Banking L. 365 (1988).

[328] This is the view taken by the Court in Board of Governors v. Dimension Fin. Corp., 474 U.S. 361, 368 (1986) (Burger, C.J.) ("no amount of agency expertise—however sound may be the result—can make the words 'legal right' mean a right to do something 'as a matter of practice;' " the intent of Congress was therefore "clearly expressed"). Justice Scalia expressed a similar view in his concurrence in INS v. Cardoza-Fonseca, 107 S. Ct. 1207, 1224 (1987) (criticizing the Court for engaging in an "ill advised" analysis of legislative history where the language of the law was "clear"). *Cf.* NLRB v. United Food & Commercial Workers Union, 108 S. Ct. 413, 426-27 (1987) (Scalia, J., concurring) (case was correctly decided "only because 'the statute is silent or ambiguous' with respect to an issue relevant to the agency's administration of the law committed to its charge").

[329] *Cf. Cardoza-Fonseca*, 107 S. Ct. at 1220-22 (examining legislative history of statutory provisions in question in determining a "pure question of statutory construction").

[330] United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 132 (1985). The Court sensibly characterized this approach as "simplistic." *Id.*

[331] *See* Chemical Mfrs. Ass'n v. Natural Resources Defense Council, Inc., 470 U.S. 116 (1985). In *Chemical Mfrs.*, the majority, after examining the legislative history of a statutory prohibition on "modifying" the requirements of the statute at issue, concluded that the prohibition was ambiguous enough to warrant deference to the construction placed upon it by the agency. *Id.* at 126-29. The dissent thought that the statute expressed the "clear intent of Congress." *Id.* at 135 (Marshall, J., dissenting).

[332] Breger, *Conference on Statutory Interpretation: The Role of Legislative History in Judicial Interpretation—Introductory Remarks*, 1987 Duke L.J. 362, 370. Of course, an investigation of legislative history does not guarantee that clarity will emerge. For a recent debate on the well-known difficulties associated with the use of legislative history, see *Conference on Statutory Interpretation: The Role of Legislative History in Judicial Interpretation*, 1987 Duke L.J. at 361-86.

2. *Sections 1464(d)(6)(C), 1464(d)(11) and 1729(d): History, Context and Application.* The FHLBB and the FSLIC rely upon three statutory provisions as constituting combined authority for administrative claims adjudication. Section 1464(d)(11) supplies the general authority to enact rules governing the adjudication of claims.[337] Section 1729(d)

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[333] *See Hudspeth, supra* note 103, 756 F.2d at 1103; *see also* Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104, 1106-07 (D. Kan. 1988); Keller v. Antioch Sav. & Loan Ass'n, 143 Ill. App. 3d 278, 285, 492 N.E.2d 937, 941 (1986). In Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1215 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451), the court recognized that the FHLBB was entitled to *Chevron* deference but found that this deference could "not save an agency interpretation that is contrary to clear congressional purpose." For a discussion of the *Hudspeth* and *Morrison-Knudsen* courts' conflicting applications of *Chevron*, see Note, *supra* note 327, at 395-96.

[334] *See* Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093 (1987). Strauss suggests that the Court has two good reasons for commanding deference to agencies' construction of their statutory mandates: the national responsibility of the agencies has a centralizing effect on the application of the law, and conflicts arising from independent review of legal questions in the circuits cannot be adequately resolved by the Supreme Court, given the limitations on its resources. *Id.*

[335] *Cf.* Diver, *Statutory Interpretation in the Administrative State*, 133 U. PA. L. REV. 549 (1985) (advocating a presumption of deference toward agencies' construction of their governing statutes); Gerwin, *The Deference Dilemma: Judicial Responses to the Great Legislative Power Giveaway*, 14 HASTINGS CONST. L.Q. 289 (1987) (reviewing and criticizing the current mood of, and the inconsistencies associated with, deference in all aspects of judicial review of agency action).

[336] *Cf.* Langevoort, *Statutory Obsolescence and the Judicial Process: The Revisionist Role of the Courts in Federal Banking Regulation*, 85 MICH. L. REV. 672 (1987) (studying the behavior of courts faced with dilemma of interpreting obsolete statutes governing banking).

[337] *See supra* text accompanying note 187 (quoting § 1464(d)(11) in full).

supplies the FSLIC's power as receiver to adjudicate claims.[338] And section 1464(d)(6)(C) precludes the courts from "restraining" or "affecting" the receivership, thereby according to the FHLBB and, in turn, the FSLIC, exclusive authority to determine the disposition of creditor claims.[339]

In what follows, an attempt will be made to place these provisions in their proper context by tracing their genealogy.[340] The conclusion will be that it is unlikely that either section 1464(d)(6)(C) or section 1729(d) was intended to confer claims adjudication authority on either the FHLBB or the FSLIC. On the other hand, it will be recognized that if the FHLBB were able to satisfy the many *constitutional* concerns involved,[341] the general regulatory authority possessed by the FHLBB under section 1464(d)(11) might be sufficiently broad to provide *statutory* authority for the creation by the FHLBB of an administrative adjudication scheme.

a. Early practices. There were no federally chartered thrifts before 1933.[342] State regulatory arrangements varied widely, though a fairly common feature was the vesting of receivership responsibility in the state agency responsible for the general supervision of thrifts, and the exemption of thrifts from the ordinary provisions pertaining to bankruptcy.[343] On the other hand, it was also common practice to subject the liquidation and claims determination process to the supervision of a state court;[344] indeed, this remains the case.[345]

During the nineteenth century there had, however, developed two forms of receivership applicable to financial institutions. The first was the traditional "equitable," or court-directed receivership, and the second was the statutory, or agency-managed receivership.[346] The latter model reflected conscious efforts by particular states to impose a coherent scheme of banking regulation on financial institutions, and it was designed to replace any traditional equitable receivership that might otherwise be instituted in the event of a bank or thrift failure.

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[338] *See supra* text accompanying note 186 (quoting § 1729(d) in full).

[339] *See supra* text accompanying note 178 (quoting § 1464(d)(6)(C) in full).

[340] The most thorough judicial analysis to date is that contained in Summertree Venture III v. FSLIC, 742 S.W.2d 446, 450-52 (Tex. Ct. App. 1987).

[341] *See infra* text accompanying notes 658-84.

[342] *See supra* text accompanying notes 40-42.

[343] *See* HISTORY OF BUILDING AND LOAN, *supra* note 40, at 129.

[344] *See* Pfeiler, *supra* note 54, at 466 n.119 (citing California, Minnesota and Pennsylvania statutes).

[345] *See, e.g.*, ILL. ANN. STAT. ch. 17, ¶ 3310-5 (Smith-Hurd 1981 & Supp. 1988); IND. CODE ANN. § 28-1-3.1-10 (Burns 1986); MASS. ANN. LAWS ch. 167, §§ 28-29 (Law. Co-op. 1987); MD. FIN. INST. CODE ANN. §§ 9-702, 9-708 (1986); N.Y. BANKING LAW §§ 623-624 (McKinney 1971); TEX. REV. CIV. STAT. ANN. arts. 342-811 (Vernon 1973); VT. STAT. ANN. tit. 8, § 1660 (1984).

[346] *See, e.g.*, *In re* Union Bank, 176 A.D. 477, 481-82, 163 N.Y.S. 485, 488-89 (1917). *See generally* Note, *Statutory Control over the Dissolution of Building and Loan Associations*, 35 COLUM. L. REV. 265 (1935).

The evolution of the statutory receivership placed in question the supervisory jurisdiction of the courts that would otherwise have retained control over the receivership. The courts soon recognized that, as in other areas where the legislature had vested statutory powers in an officer or agency, it was not for them to gainsay the exercise of those powers by the legislature's delegate. So, for example, when the Comptroller of the Currency was empowered to appoint receivers for failed national banks, the federal courts emphasized that, in the absence of abuses of power,[347] the discretionary actions of the receiver (for example, decisions as to the realization and distribution of receivership assets) could not be modified by the courts.[348] A plurality of the New York Appellate Division emphasized that the receivership decisions of the New York Superintendent of Banks were not automatically subject to judicial proceedings.[349]

But this deference extended only to the *discretionary* statutory powers vested in receivers: where, on the other hand, the nondiscretionary question of the *existence* of a valid claim was concerned, the courts seemed to have no doubt that the decisions of statutory receivers, unlike those of some equitable receivers,[350] were subject to de novo review.[351] For example, it was recognized that creditors of national banks in receivership could establish the validity of their claims in court,[352] and one state court even recognized that, notwithstanding its clearly established deference towards receivers where the latter were exercising discretionary receivership powers, the actual *priority* of a creditor's claim (let alone its mere validity) was a matter justiciable in the courts.[353]

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[347] Review for abuse of power has always been contemplated. *See, e.g.*, United States v. Knox, 102 U.S. 422, 425 (1880); Hulse v. Argetsinger, 12 F.2d 933, 936 (W.D.N.Y. 1926); Fifer v. Williams, 5 F.2d 286, 289 (9th Cir. 1925); *Union Bank*, 176 A.D. at 485, 163 N.Y.S. at 490-91.

[348] *See, e.g.*, Earle v. Pennsylvania, 178 U.S. 449, 454-55 (1900); Bushnell v. Leland, 164 U.S. 684, 685-86 (1897); Casey v. Galli, 94 U.S. 673, 677, 681 (1876); Kennedy v. Gibson, 75 U.S. (8 Wall.) 498, 505 (1869); *Argetsinger*, 12 F.2d at 935-36; *In re* Earle, 92 F. 22, 22 (C.C.E.D. Pa. 1899); Merrill v. First Nat'l Bank, 75 F. 148, 152-53 (5th Cir. 1896); Altman v. McClintock, 20 F.2d 226, 231, 233 (D. Wyo. 1927); *see also* Barse, *A Summary of the Procedure and Principles Relating to the Liquidation of National Banks in Receivership*, FED. B.A.J., Oct. 1932, at 3, 4 ("Such liquidation is not subject to the supervision of either the state or federal courts, and is purely administrative in character.").

[349] *Union Bank*, 176 A.D. at 483, 163 N.Y.S. at 490.

[350] *See, e.g.*, State *ex rel.* Pitts v. Peter Cooper Bldg. & Loan Ass'n, 74 Mo. App. 167 (1898) (refusing to conduct full de novo review of a court-appointed commissioner's determination of the validity of a creditor's claim, the commissioner being viewed as equivalent to a referee in chancery).

[351] *Execution* of the claim, on the other hand, was not permitted. *See, e.g.*, Cosmopolitan Trust Co. v. Suffolk Knitting Mills, 247 Mass. 530, 143 N.E. 138 (1924) (creditor could secure judgment as to the validity of its claim, but not set off); *see also* Barse, *supra* note 348, at 5.

[352] *See, e.g.*, *Earle*, 178 U.S. at 455; Bank of Bethel v. Pahquioque Bank, 81 U.S. (14 Wall.) 383, 401 (1871); *Kennedy*, 75 U.S. (8 Wall.) at 506 (1869) ("The claims of creditors may be proved before the comptroller, or established by suit against the association."); Schulenberg v. Norton, 49 F.2d 578, 580 (8th Cir. 1931) ("The statute provides an easy, speedy manner of determination of claims by permitting such to be presented to a receiver appointed by the Comptroller, but this is

Thus the principle of limited, deferential judicial review with regard to statutory receiverships was well established long before the imposition of federal thrift receiverships. On the other hand, this deference was not extended to the nondiscretionary decisions of statutory receivers. As we have already seen, the FSLIC and the FDIC are directed, when appointed as receivers of federal thrifts, to "pay all valid credit obligations"[354]—a formulation that does not obviously suggest discretion in the receiver. So prior financial receivership law, however progressive, offers little support to the FHLBB and the FSLIC in their efforts to establish exclusive authority to adjudicate the validity of creditor claims.

b. Inception of federal regulation and deposit insurance. The first federal involvement was in response to the drain on savings that occurred during the Great Depression.[355] Although thrifts remained healthier than commercial banks, people were forced to draw on their savings as economic conditions deteriorated. This severely limited the flow of funds to housing.[356] Congress therefore devised a scheme whereby a system of regional "home loan banks" would be established for the purpose of providing an alternative source of funds to state thrifts. The scheme was embodied in the Federal Home Loan Bank Act, signed by President Hoover on July 22, 1932.[357] The Federal Home Loan Bank Board was created for the purpose of chartering and supervising the regional home loan banks,[358] and state thrifts were eligible to become members of the system by purchasing stock in one of the home loan banks.[359] The

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quite different from limiting the ordinary and usual way of determining rights of creditors judicially."); *Merrill,* 75 F. at 153; *Altman,* 20 F.2d at 231-32; *see also* Barse, *supra* note 348, at 5:

> If a claim is disallowed the creditor may file suit in either a state or a Federal court to establish his claim, but the judgment can do no more than establish the claim, and no execution can issue against the receiver, the time of payment being a matter vested in the administrative discretion of the Comptroller.

[353] *See* Huey v. Rinehart, 116 W. Va. 309, 180 S.E. 263 (1935); *see also* Allen v. United States, 285 F. 678, 683-84 (1st Cir. 1923) (in a claim brought against an insolvent bank now run by the Commissioner of banks, federal court had jurisdiction to determine whether cash deposits created a trust in favor of the United States).

[354] *See supra* text accompanying note 184.

[355] For a valuable early account, see 5 FHLBB ANN. REP. 1-3 (1938).

[356] *See* Barth & Regalia, *supra* note 40, at 124.

[357] Ch. 522, 47 Stat. 725 (codified as amended at 12 U.S.C. §§ 1421-1449 (1982 & Supp. IV 1986).

[358] 12 U.S.C. § 1437(a) (1982 & Supp. IV 1986).

[359] Where state law prohibited them from purchasing stock, they were nevertheless permitted to borrow from the home loan banks as nonmembers. 12 U.S.C. § 1426 (1982).

scheme provided thrifts with access to a greater pool of funds, but it also subjected them to federal regulation and supervision in that to remain eligible for membership in, or borrowing from, a home loan bank they had to comply with interest rate, liquidity and lending requirements imposed by the banks.[360]

As the economy deteriorated, however, increasing numbers of homeowners found themselves subjected to escalating interest rates and foreclosures. Moreover, numerous thrifts had failed and the availability of mortgage funds was drastically reduced or, in more than 1500 counties, had simply disappeared.[361] These circumstances prompted President Roosevelt, on April 13, 1933, to request emergency legislation from Congress, and this request was met, less than two months later, by the passage of the Home Owners' Loan Act of 1933.[362]

The Act created the Home Owners' Loan Corporation for the purpose of providing an emergency supply of mortgage funds in distress cases.[363] It also facilitated, for the first time, the creation of federal savings and loan associations: the FHLBB was empowered to charter mutual thrift associations,[364] to allow state-chartered members of a home loan bank to convert to federal charter,[365] and to regulate and provide for the liquidation of these associations, "including the power to appoint a conservator or a receiver to take charge of the affairs of any such association, and to require an equitable readjustment of the capital structure of the same."[366] Federal thrifts were to be strictly confined in their operations to narrow geographic localities.[367]

At this stage no guidance was given by Congress as to how thrifts should be liquidated. The FHLBB was merely given the general authority already quoted. The legislative history is devoid of any reference to the FHLBB's power to liquidate federal thrifts, the primary concern of the legislators being the creation of the Loan Corporation and the provision of funds for home mortgages.[368] This is hardly surprising: not only was the legislation rushed through Congress,[369] but the nature of the thrift industry as it was then would hardly have suggested complicated claims determinations. The overwhelming bulk of thrift creditors would have been depositors, for whom records would have been well-documented. Besides, the systems of state regulation provided ample precedents toward which a new federal agency might look for guidance as it developed its own system of regulation. Hence it is reasonable to assume that Congress would have regarded liquidation as a concern best left to the FHLBB.[370]

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[360] *See* 12 U.S.C. § 1431.

[361] *See* H.R. Rep. No. 55, 73d Cong., 1st Sess. 2 (1933); Barth & Regalia, *supra* note 40, at 124 & n.10.

[362] Ch. 64, 48 Stat. 128; *see* Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U.S. 141, 163 n.18 (1982).

[363] Home Owners' Loan Act, ch. 64, § 4, 48 Stat. at 129-32, *repealed by* Act of June 30, 1953, ch. 170, § 21, 67 Stat. 126 (codified at 12 U.S.C. § 1463).

[364] Home Owners' Loan Act, ch. 64, § 5(a), 48 Stat. at 132.

[365] *Id.* § 5(i), 48 Stat. at 134.

[366] *Id.* § 5(d), 48 Stat. at 133.

[367] *See id.* § 5(c), 48 Stat. at 132 (confining thrifts to a 50-mile geographic limit, with limited exceptions).

[368] *See, e.g.*, S. Rep. No. 91, 73d Cong., 1st Sess. (1933); H.R. Rep. No. 55, 73d Cong., 1st Sess. (1933); H.R. Conf. Rep. No. 210, 73d Cong., 1st Sess. (1933).

The provision of emergency, low-interest funds for home mortgages actually exacerbated the difficulties of many thrifts.[371] This induced Congress to enact the National Housing Act in 1934.[372] Title IV of the Act[373] instituted a system of deposit insurance, largely along the lines of the system recently introduced for banks,[374] and created the FSLIC as an agency to operate under the direction of the FHLBB.[375] Congress had two objectives in passing the Act: first, to protect the small depositor;[376] but, perhaps even more importantly, to serve the vital public, monetary function of restoring "to the community, as quickly as possible, circulating medium destroyed or made unavailable as a consequence of bank failures."[377]

c. *Introduction of section 1729(d).* In the National Housing Act Congress was a little more specific about liquidations: the FSLIC was required to pay out insured depositors or transfer their accounts, in the event of a thrift account,[378] and was required to act as receiver if the defaulting thrift was a federal one.[379] As receiver the FSLIC was required to pay "all valid credit obligations" of the failed thrift.[380] And it was in this Act that the original provision codified at 12 U.S.C. section 1729(d) was first introduced.[381] Except for amendments clarifying the exclusive regulatory authority of the FHLBB over the FSLIC when the latter acts as receiver of a state thrift, the provision has remained basically unchanged.[382]

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[369] *See* Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U.S. 141, 163 n.18 (1982).

[370] *See infra* text accompanying notes 522-24; *cf.* Fahey v. Mallonee, 332 U.S. 245, 250 (1947) (recognizing the constitutionality of broad delegation to FHLBB in view of the "accumulated experience of supervisors, acting for many states under various statutes" that "has established well-defined practices for the appointment of conservators receivers and liquidators").

[371] *See* Barth & Regalia, *supra* note 40, at 124.

[372] Ch. 847, 48 Stat. 1246 (codified as amended at 12 U.S.C. §§ 1701-1750g (1982)).

[373] *Id.* §§ 401-407, 48 Stat. at 1255 (codified as amended at 12 U.S.C. §§ 1724-1730(g)).

[374] Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. §§ 1811-1832 (1982)); *see supra* text accompanying notes 26, 43.

[375] National Housing Act, ch. 847, § 402, 48 Stat. at 1255 (codified as amended at 12 U.S.C. § 1725 (1982)).

[376] *See, e.g.*, 80 CONG. REC. 11,200 (1934) (statements of Reps. Williams and Dirksen).

[377] Golembe, *The Deposit Insurance Legislation of 1933: An Examination of its Antecedents and its Purposes*, 75 POL. SCI. Q. 181, 189 (1960). The author is referring to bank deposit insurance, but the same reasoning applies to thrift deposit insurance.

[378] 12 U.S.C. § 1728(b) (1982).

[379] 12 U.S.C. § 1729(b) (1982).

Once again, however, the legislative history adds little to the text of the Act. The overall plan of deposit insurance was obviously very close to that of the bank deposit insurance scheme that had been created exactly one year before.[383] In hearings before the House Committee, the General Counsel of the FHLBB described the insurance payout options of the FSLIC as receiver as being "substantially the same thing as in the Bank Deposit Insurance Corporation legislation,"[384] and in the House Committee Report the legislation is described as having made "[a]dequate provision . . . for the liquidation of insured institutions somewhat similar to the plan for the liquidation of banks which are under Federal deposit insurance."[385] Beyond these sparse hints that the practice of the FDIC was to be the model,[386] the legislative history casts no further light on the meaning of the words "settle, compromise or release," "do all other things that may be necessary in connection therewith," and "subject only to the regulation of the court or other public authority having jurisdiction over the matter," that have been used in section 1729(d).[387]

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[380] *Id.* The Act draws no distinction between FSLIC Corporate and the FSLIC Receiver, since the same provision also requires FSLIC Corporate to pay the failed thrift's insurance upon being appointed receiver. *See* 12 U.S.C. § 1729(b)(2) (Supp. IV 1986).

[381] National Housing Act § 406(d), 12 U.S.C. § 1729(d) (1982) (quoted as originally enacted *supra* at note 186). The Fifth Circuit in *Hudspeth* incorrectly assumed that section 1729(d) had been introduced by the Bank Protection Act of 1968. For background on the Bank Protection Act, see *infra* text accompanying notes 407-12. *See Hudspeth, supra* note 103, 756 F.2d at 1101 n.2. The court thus wrongly assumed that this provision was introduced in the context of legislation concerned with reducing delay and minimizing costs in FSLIC receiverships. The effect of the 1968 Act was merely to extend section 1729(d) to receiverships involving state-chartered thrifts. *See* Pfeiler, *supra* note 54, at 440-41.

[382] *See supra* note 186; *see also infra* text accompanying notes 415-19.

[383] *See supra* note 43.

[384] STAFF OF HOUSE COMM. ON BANKING & CURRENCY, 73D CONG., 2D SESS., HEARINGS ON H.R. NO. 9620, HOUSING ACT AMENDMENTS OF 1934, at 15, 18 (Comm. Print 1934) (statement of Horace Russell, General Counsel, FHLBB).

[385] H.R. REP. NO. 1922, 73d Cong., 2d Sess. 4 (1934); *see also* 80 CONG. REC. 11,199 (1934) (statement of Rep. Williams) ("[t]his plan is analogous to the bank-deposit insurance provided at the last session").

[386] *See infra* text accompanying notes 430-48.

[387] Nor are the FSLIC's early reports much help. In its first annual report, the FSLIC merely describes its receivership duties as including the responsibility to "liquidate [federal savings and loan associations] in a normal manner." 3 FHLBB ANN. REP. 73 (Jan. 1-June 30, 1935). A perusal of the early annual reports reveals that the FSLIC has always attempted to avoid liquidation where

d. Judicial determination of disputed insurance claims. In the Housing Act of 1954[388] Congress amended both the National Housing Act and the Home Owner's Loan Act. A statute of limitations was placed upon actions to enforce deposit insurance claims against the FSLIC.[389] This is significant for our purposes because, though the FSLIC has made some headway with the *Hudspeth* doctrine even in this context,[390] the statutory reference to judicial challenges would seem to indicate that, at least in the case of claims involving insured deposits—the most likely type of claim in a thrift liquidation, given the restricted nature of thrift business at that time—Congress did contemplate the judicial determination of claims where their validity was in dispute.[391]

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possible and, if liquidation is inevitable, to minimize the costs of liquidation. *See, e.g.*, 8 FHLBB ANN. REP. 101, 120 (July 1, 1939-June 30, 1940); 9 FHLBB ANN. REP. 128 (July 1, 1940-June 30, 1941). But references to the *process* of liquidation were always couched in vague terms.

On the other hand, some indication that the FHLBB and FSLIC regarded the judicial process as the appropriate means of resolving disputed creditor claims is evident from the fact that in early receivership litigation the FSLIC made no objection to the courts' jurisdiction to determine the validity of claims. *See, e.g.*, Deep Rock Oil Corp. v. Salisbury, 130 F.2d 387 (8th Cir. 1942) (deciding dispute between bankrupt oil corporation and savings and loan for which FSLIC had been appointed receiver); Community Fed. Sav. & Loan Ass'n v. Fields, 128 F.2d 705 (8th Cir. 1942) (deciding employment contract dispute between employee and savings and loan for which FSLIC was the appointed receiver); Town of Texhoma *ex rel.* Versluis v. Neild, 9 F.R.D. 739 (W.D. Okla. 1943) (hearing motion to strike brought by FSLIC, receiver). In *Fields*, the receiver did object that the claimant had failed to "file" the claim with the receiver, but the court appears to have accepted that this had been done orally and that the claim had been rejected orally. 128 F.2d at 706-07. In any event, the court then proceeded to adjudicate the merits of the claim itself.

[388] Ch. 649, §§ 501, 503, 68 Stat. 590, 633-37 (codified as amended at 12 U.S.C. §§ 1725, 1464 (1982)).

[389] *Id.* § 501(2), 68 Stat. at 633 (codified as amended at 12 U.S.C. § 1728 (1982)) (adding § 405(c) to the National Housing Act).

[390] The FSLIC's attempt to extend the *Hudspeth* doctrine to claims involving insured deposits by arguing that the claimant is entitled not to review de novo, but only to APA-type review, was rejected in Jugum v. FSLIC, 637 F. Supp. 1045, 1046-48 (W.D. Wash. 1986). The *Jugum* decision has now been vacated as moot. Telephone interview with David A. Felt, Assistant General Counsel, FHLBB (Apr. 28, 1988); *cf.* Herbert v. NCUAB, 663 F. Supp. 833, 839-44 (E.D. Mo. 1987) (NCUAB decisions pursuant to 12 U.S.C. § 1687(c)(1) are not subject only to arbitrariness review under the APA) (discussed *infra* in text accompanying notes 468-72).

On the other hand, the FSLIC has successfully secured the application of the *Hudspeth* doctrine in other cases involving insured depositors' claims. *See, e.g.*, York Bank & Trust Co. v. FSLIC, 663 F. Supp. 1100 (M.D. Pa. 1987) (holding that any claim arising from the FSLIC's power as a receiver is limited to remedies provided under the APA), *vacated on other grounds*, 851 F.2d 637 (3d Cir. 1988) (court divided 2 to 1 on this issue); Baskes v. FSLIC, 649 F. Supp. 1358, 1365 (N.D. Ill. 1986) (claim of negligence brought against FSLIC dismissed because administrative remedies not exhausted); *cf.* Wyatt v. FSLIC, 685 F. Supp. 196, 198 (E.D. Ark. 1988); Berz v. FSLIC, No. CA3-87-0681-R, slip op. at 4 (N.D. Tex. Feb. 15, 1988) (APA-type review applied in granting summary judgment to FSLIC on its determination of validity of insured depositors' claims).

[391] This was one of the provisions of the National Housing Act that convinced the Ninth Circuit in *Morrison-Knudsen* that the judicial determination of other creditor claims could not have been precluded. *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1220 (9th Cir. 1987),

The Act also made provision for the FHLBB to secure enforcement orders, administratively and judicially, against delinquent thrifts as an alternative to placing them in conservatorship or receivership.[392] It enunciated specific grounds for, and required formal administrative hearings in the case of, the appointment of conservators, receivers and supervisory representatives.[393] It is worth noting that here, where Congress specifically addressed the question of administrative adjudication, it prescribed detailed procedures and principles upon which decisions should be based.

e. Introduction of section 1464(d)(6)(C). In 1966, after the FHLBB had been experiencing difficulty in securing the cooperation of the managers of some delinquent thrifts,[394] Congress, in the Financial Institutions Supervisory Act of 1966,[395] granted the FHLBB power to issue and seek enforcement of cease and desist orders, as an alternative to the FHLBB's power to place thrifts in receivership and as an alternative to the FSLIC's power to terminate the insurance of a delinquent institution, both actions being considered sometimes too drastic.[396] Most importantly, the Act also inserted for the first time subsection 1464(d)(6)(C), which forbids the courts from "restrain[ing] or affect[ing] the exercise of powers . . . of a . . . receiver," except at the instance of the Board.[397] Subsection 1464(d)(6)(C) is one of the bases upon which the agencies assert exclusive claims adjudicatory power.

This preclusion of court jurisdiction is ambiguous. It was formulated within the context of a provision that is primarily concerned with the appointment and removal of, and not the discharge of functions by, conservators and receivers. Subsection (8) of the insertion made provision for court applications by the FHLBB, "in its discretion," for the enforcement of notices issued by it under its extended powers, including not only the issue of cease and desist orders but also the appointment and

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petition for cert. filed sub nom. FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[392] Housing Act, ch. 649, § 503(2), 68 Stat. at 634-36 (codified as amended at 12 U.S.C. § 1464 (1982)) (amending § 5(d) of Home Owners' Loan Act of 1933).

[393] *Id.* § 503(2), 68 Stat. at 635-36 (codified as amended at 12 U.S.C. § 1464).

[394] *See, e.g.*, S. Rep. No. 1482, 89th Cong., 2d Sess. 5-6, *reprinted in* 1966 U.S. Code Cong. & Admin. News 3532, 3537-38; House Comm. on Banking & Currency, 89th Cong., 2d Sess., Financial Institutions Supervisory and Insurance Act, Hearings on H.R. 17899, at 33, 37 (Comm. Print 1966) (statement of John E. Horne, Chairman, FHLBB) [hereinafter Statement of John E. Horne]).

[395] Pub. L. No. 89-695, 80 Stat. 1028 (codified as amended at 12 U.S.C. § 1464(d)).

[396] *See, e.g.*, Statement of John E. Horne, *supra* note 394, at 36.

[397] Financial Institutions Supervisory Act, Pub. L. No. 89-695, § 6(C), 80 Stat. at 1033 (codified as amended at 12 U.S.C. § 1464(d)(6)(C)).

removal of receivers.[398] This would suggest that Congress was concerned, not with details such as the determination of valid creditor claims, but with the creation, responsibility, and termination of receiverships, and the need to subject these concerns to the authority of the FHLBB. What Congress appeared to have in mind in precluding courts from "restraining" or "affecting" receiverships was the possibility that a FHLBB-appointed receiver might be harassed in the exercise of its wide-ranging discretionary powers by injunctions issuing from state courts at the instance, for example, of aggrieved ex-directors. Viewed from this perspective, subsection 1464(d)(6)(C) seems little more than a strengthening and codification of the principle of deference toward discretionary receivership powers that had long before been developed by state and federal courts in relation to statutory financial receiverships,[399] and the provision does not necessarily imply that the validity of the credit obligations that the receiver is bound to pay should not, when in dispute, be settled in court.[400]

Furthermore, wherever Congress expressly addressed the subject of adjudication, it again made provision for the conduct of hearings[401] and provided for judicial review under the APA.[402] If administrative claims adjudication and exclusion of the courts had been contemplated, one might expect Congress to have been more explicit in expresing such intent: after all, the Chairman of the FDIC had specifically stated when describing the purpose and contents of the House bill that "[t]here are carefully drawn provisions with respect to administrative hearings and judicial review which fully protect the rights of individuals and insured institutions against whom action may be taken by the supervisory agencies."[403]

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[398] *Id.*, § 101(a), 80 Stat. at 1028 (codified at 12 U.S.C. § 1464(d)(8)) (adding new § 5(d)(8) to Home Owners' Loan Act). The provision of this facility does indicate how much responsibility Congress has been prepared to entrust to the FHLBB: few other agencies have authority to prosecute enforcement actions without the participation of an independent prosecutorial agent. *See* Diver, *A Theory of Regulatory Enforcement*, 28 PUB. POL'Y 257, 287 (1980).

[399] *See supra* text accompanying notes 347-53.

[400] *Cf.* Statement of John E. Horne, *supra* note 394, at 38 ("As a matter of fact, there can be no doubt that the approach of this bill markedly increases the role of judicial review in the process of supervision of financial institutions. At the same time, the Board believes it essential for the supervisory agency that examines and is familiar with the developments in a financial institution to be able to judge when action is necessary and what action is appropriate, and to act promptly if the matter is urgent."). If exclusive claims adjudicatory power had been sought by the Board, one would expect the General Counsel, whose office actually drafted the bill, to have requested it. There is no mention of the subject in the General Counsel's statement.

[401] *See* Financial Institutions Supervisory Act of 1966, Pub. L. No. 89-695, §§ 101(a), 102, 80 Stat. 1028, 1028, 1036 (inserting § 5(d)(7) into the Home Owners' Loan Act, 12 U.S.C. § 1464(d)(7) (1982), and amending § 407 of the National Housing Act, 12 U.S.C. § 1730(j)(2) (1982)).

[402] *See* S. REP. NO. 1482, *supra* note 394, at 15, 25, *reprinted in* 1966 U.S. CODE CONG. & ADMIN. NEWS at 3546, 3557 (section-by-section analysis). The House bill, H.R. 17899, provided for judicial review according to the "weight of the evidence" standard. *See* H.R. REP. NO. 2077, 89th Cong., 2d Sess. 6 (1966) (the standard of review should be a "weight of the evidence" rather than "substantial evidence" standard). But the Senate bill, S. 3158, was passed in lieu of the House bill and the modification was dropped. *See also infra* text accompanying note 504.

f. Introduction of section 1464(d)(11). On the other hand, the 1966 Act added more detail to the general power of the FHLBB to regulate the conduct of receiverships. It introduced the predecessor to the present section 1464(d)(11),[404] which is expressed in very broad terms.[405] The legislative history provides no indication as to the intention of Congress with regard to this provision,[406] so it is quite plausible that the legislative intention was for the FHLBB to deal with claims adjudication as a matter of administrative detail and agency expertise.

g. Extension of receivership appointment powers. The Bank Protection Act of 1968[407] extended the powers of the FHLBB to appoint the FSLIC as receiver of insolvent state thrifts. This was effected against a background of obstruction on the part of the Illinois authorities, who had refused to appoint the FSLIC as receiver in four cases even though the FSLIC was the insurer of deposits in those thrifts and by far the major creditor.[408] The state authorities had for a number of months denied the FSLIC access to information concerning the thrifts; during this time their financial condition deteriorated rapidly, to the ultimate cost of the Insurance Fund.[409] Congress was concerned that the FHLBB and the FSLIC should be able to act quickly in such cases,[410] so it extended the former's powers to appoint the FSLIC as receiver, and extended the operation of section 1464(d)(6)(C) to FSLIC receiverships involving state-chartered thrifts.[411] Given the fact that the claims of creditors other than the FSLIC amounted to less than 5%,[412] it is hardly likely that the claims determination process was within the contemplation of Congress.

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[403] House Comm. on Banking & Currency, 89th Cong., 2d Sess., *supra* note 394, at 27 (statement of K.A. Randall, Chairman, FDIC).

[404] Financial Institutions Supervisory Act, Pub. L. No. 89-695, § 101(a), 80 Stat. at 1028 (inserting § 5(d)(11) in the Home Owners' Loan Act, 12 U.S.C. § 1464(d)(11) (1982)).

[405] 12 U.S.C. § 1464(d)(11); *see also supra* text accompanying note 187.

[406] *See* S. Rep. No. 1482, *supra* note 394, at 15, *reprinted in* 1966 U.S. Code Cong. & Admin. News at 3546.

[407] Pub. L. No. 90-389, 82 Stat. 294 (codified as amended at 12 U.S.C. §§ 1729, 1881-1884 (1982)).

[408] *See* S. Rep. No. 1263, 90th Cong., 2d Sess. 6-7, *reprinted in* 1968 U.S. Code Cong. & Admin. News 2530, 2536-37. The FSLIC was estimated to have a claim to at least 95% of the receivership assets, *see id.* at 2, 7, *reprinted in* 1968 U.S. Code Cong. & Admin. News at 2531, 2536, which again indicates how low a priority was given the concern for determination of other creditor claims.

[409] *See id.*, *reprinted in* 1968 U.S. Code Cong. & Admin. News at 2531, 2536.

[410] The Fifth Circuit in *Hudspeth* placed great emphasis on this concern, *see Hudspeth, supra* note 103, 756 F.2d at 1101, 1102, but did not explain the context in which the FHLBB and FSLIC powers were being extended to state thrifts.

The Garn-St Germain Depository Institutions Act of 1982[413] granted the FHLBB the emergency power exclusively to appoint the FSLIC as receiver for state-chartered thrifts in situations where the cooperation of state authorities had formerly been required, and it recodified the discretionary powers enjoyed by the FSLIC as receiver.[414]

h. Modification of section 1729(d). Subsection 1729(d) was also temporarily modified by the 1982 Act to make clear the FHLBB's exclusive regulatory authority over the FSLIC as receiver of state thrifts.[415] The basic power to "settle, compromise, or release" claims, and to "do all other things as may be necessary in connection therewith" remained unaffected; the intention was that the receivership powers of the FSLIC over state thrifts should be "approximately equal to those which it now has with respect to Federal Associations."[416]

Finally, the Competitive Equality Banking Act of 1987[417] made the emergency provisions of the Garn-St Germain Act, including the then-sunsetted amendments to section 1729(d),[418] permanent by deleting the sunset clauses in the 1982 Act.[419]

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[411] *See* Bank Protection Act, Pub. L. No. 90-389, § 6, 82 Stat. at 295 (modifying § 406 of the National Housing Act, 12 U.S.C. § 1729 (1982), and § 5(d) of the Home Owners' Loan Act, 12 U.S.C. § 1464(d) (1982)). The Senate Report described § 1464(d)(6)(C) as preventing the "appointment of the FSLIC as receiver by the Board" from being "subject to judicial attack." *See* S. Rep. No. 1263, *supra* note 408, at 10, *reprinted in* 1968 U.S. Code Cong. & Admin. News at 2539. The Report then emphasized that the Board's regulatory authority was to be substituted for that "of any State authority, administrative or judicial, which may previously have had regulatory authority," *id.*, and concluded that "[t]he effect of the legislation would be to enable the FSLIC to defend its appointment under Federal law instead of requiring it to defend the legality of the State savings and loan administrator's determinations under State law," *id.* at 11, *reprinted in* 1968 U.S. Code Cong. & Admin. News at 2540. Claims adjudication seems not to have been contemplated.

[412] *See supra* note 408.

[413] Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., 15 U.S.C. and 20 U.S.C.).

[414] Garn-St Germain Depository Institutions Act § 122(b), 12 U.S.C. § 1729(f) (1982).

[415] *Id.* § 122(g), 12 U.S.C. § 1729(d) (1982); *see supra* text accompanying note 186 (quoting the temporary (and now permanent) wording in full); *see also infra* text accompanying notes 417-19.

[416] S. Rep. No. 536, 97th Cong., 2d Sess. 48, *reprinted in* 1982 U.S. Code Cong. & Admin. News 3054, 3102. It is significant that Congress emphasized that the Insurance Fund would not be liable for the noninsured claims of creditors. *See id.* at 49, *reprinted in* 1982 U.S. Code. Cong. & Admin. News at 3103. This probably reflects awareness of the growing diversification of thrift business and the increasing importance of noninsured creditor claims. It also suggests that it is only at this point that legislators could have begun to address seriously the detail of creditor claims adjudication.

[417] Pub. L. No. 100-86, 101 Stat. 552 (to be codified in scattered sections of 12 U.S.C.A.).

[418] *See supra* text accompanying note 186 (quoting the final version of § 1729(d) in full).

This review highlights the ambiguity surrounding the receivership claims determination power. It is very unlikely that Congress at any stage directly addressed the matter, and neither section 1464(d)(6)(C) nor section 1729(d) can seriously be regarded as direct authority for exclusive administrative adjudication. The court in *Summertree Venture III v. Federal Savings & Loan Insurance Corp.*[420] was surely correct in concluding:

> The reasons the FSLIC can be appointed, the timing of the appointment, and the entity that is authorized to make the appointment have changed throughout the years, but the powers and functions of the receiver in connection with the liquidation have not been expanded since the original acts.[421]

i. The irrelevance of sections 1464(d)(6)(C) and 1729(d). Not only do sections 1464(d)(6)(C) and 1729(d) provide a very dubious basis for the adjudicatory powers claimed by the FHLBB and the FSLIC, but reliance upon them also involves the agencies in self-contradiction, since, ultimately, section 1464(d)(6)(C) proves too much and section 1729(d) proves too little.

If section 1464(d)(6)(C) really does preclude the jurisdiction of the courts in matters relating to claims determination, then, contrary to the FSLIC's own arguments and the *Hudspeth* decision itself,[422] judicial review "under the APA"[423] would not be available at all because the APA expressly denies judicial review where the applicable statute precludes it.[424] Hence, to be consistent, the FSLIC should have argued, and the Fifth Circuit in *Hudspeth* should have held, that judicial review is denied altogether.[425]

On the other hand, section 1729(d) confers power on the *receiver* (i.e., the FSLIC), not the FHLBB. If the power to adjudicate lies therein, then the FHLBB, in creating a structure in which adjudication really takes place only at the level of the Adjudication Division of the

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[419] Pub. L. No. 100-96, § 509(a), 101 Stat. at 635.

[420] 742 S.W.2d 446 (Tex. Ct. App. 1987).

[421] *Id.* at 453.

[422] *See Hudspeth, supra* note 103, 756 F.2d at 1103.

[423] *Id.*

[424] 5 U.S.C. § 701(a)(1) (1982).

[425] This rule has some judicial qualifications, designed to avoid due process difficulties. *See, e.g.*, Johnson v. Robison, 415 U.S. 361, 372-73 (1974) (the no-review clause of laws administered by the Veterans' Administration, 38 U.S.C. § 211(a) (1982), was designed to proscribe courts from making benefit determinations, not to proscribe judicial cognizance of constitutional challenges to veterans' benefits legislation). But these are exceptions, and it would be misleading to assume that their effect is simply to reinstate "judicial review under the APA."

Office of General Counsel of the *Board*,[426] has to that extent usurped a power conferred on the receiver. In other words, the FHLBB cannot, in claiming adjudicatory power for itself, rely on power conferred upon another agency, even if that agency is subject to its direction.

j. Section 1464(d)(11) as the best basis for the Hudspeth *scheme.* Yet it does not necessarily follow that there can be no administrative adjudication. Such a conclusion would ignore the broad power conferred on the FHLBB by section 1464(d)(11), which, under *Chevron,* would ordinarily create a strong presumption in favor of the Board's interpretation of the section.[427] The Supreme Court has determined in certain contexts that "receivership" powers do not entail a claims adjudication power,[428] but the receivership concept has been used in such widely varying contexts, and the thrift industry has been subjected to autonomous regulation for so long, that it would be an exercise in sterile conceptualism to conclude that claims adjudication is inherently precluded by the notion of receivership.

If the obfuscation of sections 1464(d)(6)(C) and 1729(d) is avoided, and constitutional concerns are left aside, the claim that the FHLBB, in the exercise of its general regulatory powers under section 1464(d)(11), can establish a claims adjudication scheme becomes much more plausible. A court could conclude that since Congress has not directly addressed the issue, as it plainly has not, the conclusion by the Board that it is empowered to establish a claims adjudication scheme is a "permissible" construction of its powers and therefore one that the court should accept.[429]

3. *FDIC and NCUAB Analogues.* Before leaving the question of statutory power it is helpful briefly to review two possible analogies, one of which might suggest that claims adjudication is not within the range of FHLBB and FSLIC powers, and the other of which tends to support the FHLBB's and FSLIC's claim. The first involves the FDIC, and the second the NCUAB.

a. The FDIC. The practice of the FDIC may be of assistance for a variety of reasons. First, the FSLIC insurance scheme was at least partly modeled on that of the FDIC,[430] and the techniques employed by the FSLIC to assist troubled thrifts are very similar to those employed by the FDIC.[431] Second, Congress has often amended and extended the receivership powers of the FSLIC and the FDIC in the same legislation.[432] Third, the activities of banks and thrifts are becoming increasingly similar.[433] The overlap is highlighted by the fact that the FDIC is appointed by, and subject to the authority of, the FHLBB when it acts as receiver for a failed federal savings bank.[434] The FDIC has indeed adopted the view that the *Hudspeth* doctrine applies to the determination of creditor claims when it is liquidating such banks.[435] Fourth, the FDIC has had longer experience in dealing with the claims of non-insured depositors[436] and faces similar problems regarding the escalation of failed banks and the depletion of its insurance fund.[437] Finally, some judicial decisions, while fully acknowledging the controlling force of *Chevron,* have directly drawn on the analogies between the two agencies in rejecting the FHLBB's and FSLIC's interpretations of their statutory mandates.[438]

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[426] *See supra* text accompanying note 250.

[427] *See supra* text accompanying notes 325-36.

[428] *See supra* text accompanying notes 108-09.

[429] *See supra* text accompanying notes 326-27 (discussing the second stage of the *Chevron* analysis). In Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 841-43 (1986), *see infra* text accompanying notes 576-88, the Court held that the CFTC had the power to create a reparations jurisdiction by rule, though there the statute seemed, in view of its direct reference to "reparation orders," more clearly to contemplate that the agency would do so.

The FDIC must be appointed receiver of failed federal savings banks, in which case appointments are made by the FHLBB, and of failed national banks, in which case appointments are made by the Comptroller of the Currency.[439] The FDIC may also accept appointment as receiver of an insured state bank if such appointment is tendered by the relevant state authority.[440]

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[430] *See supra* text accompanying notes 384-85.

[431] *See supra* note 182.

[432] *See, e.g.,* Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, § 714(a), 101 Stat. 552, 654 (codified at 12 U.S.C.A. § 1787(a)(1)(B) (West Supp. 1988); Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified in scattered sections of 12 U.S.C.); Bank Protection Act of 1968, Pub. L. No. 90-389, 82 Stat. 294 (codified at 12 U.S.C. §§ 1729, 1881-1884 (1982)); *see also supra* notes 407-19.

[433] *See supra* text accompanying notes 53-57.

[434] *See supra* text accompanying notes 167-68.

[435] *See supra* note 181.

[436] *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1221 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[437] *See, e.g.,* Nash, *FDIC Faces a Texas-Size Drain,* N.Y. Times, Mar. 17, 1988, at D1, col. 3, D6, col. 4 (city ed.).

[438] *See, e.g., Morrison-Knudsen,* 811 F.2d at 1221 (the FDIC's practice of litigating disputed claims in court supports the conclusion that the FSLIC did not have adjudicatory power); *cf.* FAIC Sec., Inc. v. United States, 768 F.2d 352, 361-64 (D.C. Cir. 1985) (Scalia, J.) (applying *Chevron* analysis and relying upon the "clarity of congressional intent expressed with regard to the FDIA" in determining whether an inconsistent interpretation by the FHLBB of the "far from clear" National Housing Act was a "permissible" one; concluding that it was not). Although *FAIC* involved the definition of insured accounts, it is still relevant: the FDIC analogy was held to be guiding even at the second stage of the *Chevron* analysis.

[439] 12 U.S.C. § 1821(c) (1982). On the rare case of federal savings bank receiverships, see *supra* text accompanying notes 167-69. For the grounds for appointing the FDIC as receiver of a national bank, see 12 U.S.C. § 191 (1982).

Upon appointment, the FDIC is required to pay insured deposits, either by cash or by means of transferred accounts.[441] With respect to insured national banks, the FDIC has a wide range of powers to provide financial assistance to insured banks in order to avoid receivership,[442] and, upon receivership, may create new banks and "bridge banks" for the purpose of implementing purchase and assumption transactions.[443]

Here the similarities with the FSLIC end. In particular, the liquidation practice of the FDIC is very different: the FDIC, unlike the FSLIC, does not assert the power to adjudicate the validity of creditor claims, whether they be those of insured depositors or uninsured and general creditors. The FDIC relies instead upon the courts to resolve these claims.[444] As a result, the FDIC makes informal, ad hoc arrangements in the case of each receivership;[445] it lacks guidelines similar to those that have been created by the FHLBB for thrift receiverships.[446]

The practice of the FDIC might therefore suggest that the assumption of adjudicatory authority by the FHLBB and the FSLIC is unjustified. But there are a number of important differences in the regulatory and statutory contexts of each agency that might justify the difference.

First, while the FDIC, when acting as reviewer of a federal savings bank, stands in the same relationship to the FHLBB as does the FSLIC when acting as receiver of a thrift, the FDIC is no longer subject to the Comptroller's regulatory authority when it is appointed by the Comptroller to act as a receiver for a closed national bank.[447] Hence the appellate structure created by the FHLBB under the *Hudspeth* doctrine is not available to the FDIC, except in the case of receiverships involving savings banks. The conflict of interest that would be involved were the FDIC to adjudicate claims in its receiverships is therefore even more intense because of the absence of institutional separation.

Second, whereas the FHLBB has long been given exclusive regulatory authority over the FSLIC's receiverships even in the case of federally insured state thrifts, the "rights, powers and privileges" of the FDIC as receiver are entirely governed by the relevant provisions of state law when it is appointed receiver of a state bank.[448] This means that the FDIC would have to abide by the claims adjudication provisions or practices of state law. Thrift receiverships stand in contrast: once under the regulatory authority of the FHLBB, the FSLIC as receiver of a state thrift is restricted only by the proviso to the jurisdictional provisions of 12 U.S.C. section 1730(k)(1).[449] The section vests jurisdiction over suits involving the FSLIC in the federal district courts, and it makes federal law controlling. But it stipulates in its proviso

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[440] 12 U.S.C. § 1821(e).

[441] 12 U.S.C. § 1821(f).

[442] *See* 12 U.S.C. § 1823(c) (1982).

[443] *See* 12 U.S.C.A. § 1821(h)-(i) (West Supp. 1988); *see also supra* note 182.

[444] By July 1987, the FDIC was involved in approximately 27,000 lawsuits involving claims against its receiverships. Interview with Carroll Shiflett, Assistant General Counsel, FDIC, in Washington, D.C. (July 21, 1987).

[445] Interview with Roger Hood, Assistant General Counsel, FDIC, in Washington, D.C. (Oct. 22, 1987).

[446] *See supra* text accompanying notes 201-05.

[447] 12 U.S.C § 1821(d).

> [t]hat any action, suit, or proceeding to which the [FSLIC] is a party in its capacity as . . . receiver . . . of an insured State-chartered institution and which involves only the rights or obligations of investors, creditors, stockholders, and such institution under State law shall not be deemed to arise under the laws of the United States.[450]

Although it has been suggested that the proviso supports the argument against claims adjudicatory powers because it indicates a "tacit assumption" on the part of Congress that such claims would be amenable to judicial resolution,[451] the proviso addresses not the *powers* of the FSLIC or the FHLBB, but only the law governing the criteria by which claims should be resolved.[452]

The guidance provided by practice at the FDIC is therefore inconclusive. At most it casts doubt upon the plausibility of the FHLBB's assumption of powers, but, especially when one considers the jurisdictional differences between the FDIC on the one hand, and the FHLBB and the FSLIC on the other, the FDIC's general practice of litigating disputed claims in court is insufficient in itself to render the FHLBB's interpretation of its powers "impermissible."[453]

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[448] 12 U.S.C. § 1821(e).

[449] *See* 12 U.S.C. § 1730(k)(1) (1982).

[450] *Id.*

[451] *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1220-21 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[452] Section 1730(k)(1) is really analogous to the fourth power established in 12 U.S.C. § 1819 (1982), which prescribes the governing law and jurisdiction in disputes involving the FDIC. *Cf. In re* FSLIC, 837 F.2d 432, 435-36 (11th Cir. 1988) (citing section 1819 cases in support of section 1730(k)(1) issue); FSLIC v. Ticktin, 832 F.2d 1438, 1444 (7th Cir. 1987) (relying heavily on section 1819 caselaw in deciding § 1730(k)(1) issue), *petition for cert. filed,* 56 U.S.L.W. 3834 (U.S. May 12, 1988) (No. 87-1865); Polk v. FDIC, No. 87-C-9433 (N.D. Ill. Mar. 1, 1988) (Westlaw, 1988 WL 19575) (cases involving FDIC removal and FSLIC removal can be cited interchangeably). *But see* FSLIC v. T.G. Partners, Ltd., 689 F. Supp. 683 (N.D. Tex. 1988) (stressing differences between section 1819 and section 1730(k)(1)).

[453] The *FAIC* case, *see supra* note 438, can be distinguished in that it involved an interpretation of depositors' substantive rights and not the means by which disputes concerning those rights should be resolved—a concern that, in the absence of constitutional constraints and explicit legislative gui-

b. The NCUAB. The receivership powers of the NCUAB are something of a hybrid. The NCUAB is empowered to place federal credit unions into liquidation and appoint itself the "liquidating agent."[454] It is also authorized to accept appointment as liquidating agent of an insured state-chartered credit union.[455] As in the case of the FDIC, in such situations it possesses the "rights, powers, and privileges" granted by the applicable state law.[456] The NCUAB, in section 1788(c), also enjoyed receivership powers that were framed, before the enactment of the Competitive Equality Banking Act of 1987,[457] in terms identical to those possessed by the FSLIC under section 1729(d) before the latter provision was amended in 1982.[458] In addition, the NCUAB, like the FDIC and the FSLIC, must pay insurance to insured depositors when a credit union is closed for liquidation and, like the FDIC and the FSLIC, can require claimants to insurance to prove the validity of their claims in court.[459]

Unlike the legislation governing thrift liquidations, however, the powers of an NCUAB liquidating agent were more explicitly articulated by the Act of July 31, 1946, which amended the Federal Credit Union Act.[460] This legislation provides that a liquidating agent "shall have power and authority, subject to the control and supervision of the [NCUAB] and under such rules and regulations as the [NCUAB] may prescribe, . . . to receive, examine, and pass upon all claims against the Federal credit union in liquidation, including claims of members on member accounts."[461] The Senate Report accompanying this amendment stated that "[t]he provisions set out in this section . . . are similar to those which are customarily prescribed in other types of liquidations and would authorize, for example, the appointment of a liquidating agent, the receipt and *adjudication* of claims, and the distribution of dividends

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dance, and in the presence of general regulatory authority (section 1464(d)(11)), might properly be regarded as the preserve of the agencies involved.

[454] *See* 12 U.S.C.A. § 1787(a)(1)(A) (West Supp. 1988).

[455] *See* 12 U.S.C. § 1787(b) (1982).

[456] *Id.*

[457] 12 U.S.C. § 1788(c) (1982) states:

> In connection with the liquidation of any insured credit union, the Board shall have the power to carry on the business of and collect all obligations to the credit union, to settle, compromise, or release claims in favor of or against the credit union, and to do all other things that may be necessary in connection therewith, subject to the regulation of the court or other public body having jurisdiction over the matter.

[458] On the 1982 FSLIC amendment, see *supra* text accompanying notes 415-19.

[459] *See* 12 U.S.C. § 1787(c)(1).

[460] Ch. 711, § 8, 60 Stat. 744, 745 (codified at 12 U.S.C. § 1766(b)(3) (1982)).

[461] 12 U.S.C. § 1766(b)(3)(B) (1982).

thereon."[462]

The 1946 legislation and the accompanying Senate Report were considered by the court in *Morrison-Knudsen* in its review of the practices and legislation pertaining to the liquidation practices of other regulatory agencies.[463] The panel concluded, however, that even if Congress had really intended to suggest that the other agencies had exclusive claims adjudicatory power (which is not at all clear from the wording used in the Report), then Congress "was mistaken."[464] In any event, the court concluded, the NCUAB legislation and history was "so remote from the cases at bar that it cannot affect our decision."[465]

The *Morrison-Knudsen* court was surely correct to doubt that Congress intended to vest the liquidating agent with an *exclusive* adjudicatory power. The 1946 amendment had also inserted a provision that expressly recognized that claims might be established through the judicial process.[466] The formulation employed was similar to that used in legislation governing the receivership of national banks prior to the creation of the FDIC, with respect to which there had been no doubt that creditors could resort to court to establish their claims.[467] It is therefore most unlikely that Congress intended that liquidating agents should have exclusive power to adjudicate claims to the preclusion of the courts.

Soon after *Morrison-Knudsen,* in *Herbert v. National Credit Union Administration Board,*[468] the exclusivity of the NCUAB's claims adjudicatory powers again became the subject of judicial scrutiny, this time within the context of determinations involving the validity of deposit insurance claims. The NCUAB argued that its determinations could not be challenged in court de novo, but were subject only to APA judicial review. In support of its argument the NCUAB invoked two cases that had expressly relied upon *Hudspeth.*[469] In effect, the NCUAB argued for an extension of the *Hudspeth* doctrine (concerning exclusive administrative claims adjudication) to the determination, in federal credit union liquidations, of the claims of *insured* depositors.

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[462] S. REP. NO. 1647, 79th Cong., 2d Sess. 2, *reprinted in* 1946 U.S. CODE CONG. SERV. 1323, 1324 (emphasis added).

[463] *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1219 n.3 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[464] *Id.*

[465] *Id.*

[466] Section 1766(b)(4)(B), which was inserted by the 1946 Act, provides that the liquidating agent shall "make a ratable dividend on all such claims as may have been proved to his satisfaction *or adjudicated in a court of competent jurisdiction.*" 12 U.S.C. § 1766(b)(4)(B) (1982) (emphasis added).

[467] *See, e.g.,* Schulenberg v. Norton, 49 F.2d 578, 580 (8th Cir. 1931) (applicable legislation required receiver to pay claims proven to his satisfaction or adjudicated in court of competent jurisdiction); *see also supra* text accompanying note 352.

[468] 663 F. Supp. 833 (E.D. Mo. 1987).

[469] Godwin v. FSLIC, 806 F.2d 1290 (5th Cir. 1987); Baskes v. FSLIC, 649 F. Supp. 1358 (N.D. Ill. 1986).

Finding no guidance in the relevant legislative history, and noting the provision of elaborate procedural prescriptions elsewhere in the Credit Union Act[470] and the absence of detailed administrative rules like those promulgated by the FHLBB,[471] the court rejected the NCUAB's argument. Chief Judge Nangle was unimpressed by the references to *Hudspeth*, which, he noted, "[did] not in any way involve an FSLIC insurance claim."[472]

The decision in *Herbert* and the reference in *Morrison-Knudsen* to the NCUAB's powers assume some significance in view of subsequent legislation passed by Congress. *Morrison-Knudsen* was decided on February 25, 1987, and *Herbert* was decided on June 29, 1987. The Competitive Equality Banking Act, which amended the NCUAB's powers, was enacted on August 10, 1987. The Act modified the NCUAB's receivership powers in two ways. First, it added a new subsection to the receivership appointment power,[473] providing for judicial challenge to the closure of a credit union, and adding a provision that serves as an analogue to section 1464(d)(6)(C).[474] Second, the 1987 Act transferred section 1788(c) (the NCUAB's equivalent of section 1729(d)) to section 1787, and amended it in terms identical to those that were used to amend section 1729(d) by the Garn-St Germain Act of 1982.[475]

Congress had thus directly addressed one aspect of the receivership powers of the NCUAB, so the legislative history has particular significance. And in the Senate Report we find, tailor-made for the adoption of the *Hudspeth* doctrine, the following statement:

> The Committee expects that liquidations conducted under this section shall be accomplished as expeditiously as possible in order to achieve minimal disruption to the financial system. Creditor, member and other claimants must be dealt with in a fair manner. *These amend-*

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[470] *See Herbert*, 663 F. Supp. at 839-40.

[471] *Id.* at 842.

[472] *Id.* (rejecting suggestions to the contrary in *Godwin*, 806 F.2d at 1292 n.4).

[473] Competitive Equality Banking Act, Pub. L. No. 100-86, § 714(a), 101 Stat. at 654 (codified at 12 U.S.C.A. § 1787(a)(1)(B) (West Supp. 1988)).

[474] "Except as otherwise provided in this subparagraph, no court may take any action for or toward the removal of any liquidating agent or, except at the instance of the Board, restrain or affect the exercise of powers or functions of a liquidating agent." *Id.*

[475] *Id.* § 714(b), 101 Stat. at 655 (codified at 12 U.S.C.A. § 1787(j) (West Supp. 1988)) (inserting the words "subject only to the regulation of the Board, or, in cases where the Board has been appointed liquidating agent solely by a public authority having jurisdiction over the matter other than the said Board, subject only to the regulation of such public authority"). On the Garn-St Germain amendments, see *supra* notes 186, 415-19 and accompanying text.

> *ments clarify the NCUA's authority to adjudicate liquidation claims. Upon final agency action, a claimant may seek recourse in court under the provisions of the APA.*[476]

While one should not place too much weight on legislative history, much of which is manufactured,[477] the wording emphasized in the passage just quoted invites speculation as to the possible motives underlying the amendments. Three possibilities suggest themselves.

First, the explicit reference to the APA as the statute governing the scope of judicial review could be taken as a renunciation of the law espoused in *Herbert*. This is an unlikely interpretation, however, since the amendments left completely unchanged section 1787(c)(1), which expressly provides for the judicial resolution of disputed insurance claims, and upon which the court in *Herbert* explicitly relied.[478]

Second, the NCUAB could have been concerned that the dicta in the *Morrison-Knudsen* opinion had cast doubt upon what the NCUAB believes to be the exclusive power of liquidating agents to adjudicate claims. The amendments may have been intended to clarify the situation.[479] If such were the motivation, however, the NCUAB might not have been successful. The amendments address sections 1787 and 1788, and not section 1766(b)(3). Yet it is the latter provision that appears to furnish the power to "adjudicate" claims and to which *Morrison-Knudsen* had referred.[480] Not only do the amendments fail to address the actual subsection interpreted by *Morrison-Knudsen* (i.e., section 1766(b)(3)), but it would also have been far simpler for Congress to have added an express provision to section 1777(b)(3) stating that the power to adjudicate claims was exclusive, or subject only to APA review. It is also difficult to understand why the NCUAB drafters chose to adopt the very terminology[481] that had been in issue in *Morrison-Knudsen* in the FSLIC context, and which the court had interpreted so as to *exclude* the power to adjudicate claims,[482] was adopted. Instead, the amendments could simply have incorporated the explicit terminology used in the Senate Report, thus avoiding the obscure and highly contentious verbiage of sections 1464(d)(6)(C) and 1729(d).

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[476] S. REP. No. 19, 100th Cong., 1st Sess. 25, *reprinted in* 1987 U.S. CODE CONG. & ADMIN. NEWS 489, 515 (emphasis added).

[477] *Cf.* Starr, *Conference on Statutory Interpretation: The Role of Legislative History in Judicial Interpretation—Observations About the Use of Legislative History*, 1987 DUKE L.J. 371, 376-77 (describing the "virtual cottage industry" engaged in fashioning legislative history "so that the Congress will appear to embrace their particular view in a given statute").

[478] *See* 663 F. Supp. 833, 843 (E.D. Mo. 1987). Staff at the NCUAB assert that the *Herbert* decision was not the motive for obtaining the amendment. Telephone interview with Leslie A. Conover, Staff Attorney, FDIC (May 11, 1988).

[479] This is the explanation provided by staff at the NCUAB. Telephone interview, *supra* note 478.

[480] *See supra* text accompanying notes 460-65.

[481] The modification of the terminology to comport with the post-1982 wording of the FSLIC's section 1729(d) adds nothing of substance to the legislation. *See supra* notes 186, 415-16 and accompanying text.

Given the similarity in wording and structure of the amended NCUAB provisions to those applicable to the FHLBB and FSLIC, a third possibility might be that the legislation and legislative history were unwisely framed under the influence of the chaotic jurisprudence spawned by the *Hudspeth* decision. This would explain why the drafters chose to focus on the analogues to sections 1464(d)(6)(C) and 1729(d).

In any event, because the 1987 amendments did address the NCUAB analogues to sections 1464(d)(6)(C) and 1729(d), and because the amendments reformulated the NCUAB provisions in terms that are virtually identical to pertinent parts of sections 1464(d)(6)(C) and 1729(d), the legislative history accompanying the amendments constitutes an endorsement of the contentions of the FHLBB and FSLIC. Yet the strength of this endorsement will depend on how seriously one should regard this legislative history and whether the reliance upon sections 1464(d)(6)(C) and 1729(d) as the sources of adjudicatory power has any merit at all.[483]

In conclusion, we can assume that, while it is doubtful that the FHLBB and the FSLIC enjoy exclusive claims adjudicatory authority by virtue of the provisions of sections 1464(d)(6)(C) and 1729(d), under section 1464(d)(11) the FHLBB could, *in the absence of constitutional difficulties,*[484] enjoy authority, murky though it certainly would be, to establish an administrative claims adjudication scheme. In order to complete the analysis of the legislative constraints, and before examining the constitutional constraints, we need to consider the supplementary application of the APA.

4. *Application of the APA.* Given the wording of the FSLIC's statutory mandate, it is unlikely that any of the formal procedural requirements of the APA[485] apply to the receiver when these claims are

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[482] The court in *Morrison-Knudsen* thought that Congress's failure to speak more explicitly in the 1982 amendments actually detracted from the force of the agencies' arguments. *See* Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1221 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[483] *See supra* text accompanying notes 422-26 (arguing that sections 1464(d)(6)(C) and 1729(d) are red herrings).

[484] The principle of deference dictated by *Chevron* is balanced by the principle of strict construction when agency powers impinge upon constitutional protections. *See supra* text accompanying notes 129-30.

[485] 5 U.S.C. §§ 554-557 (1982).

being adjudicated. *Hudspeth* adjudications are likely to be construed as informal adjudications, and thus the only procedural requirements beyond those dictated by the FHLBB in its rules would be those dictated by constitutional due process.[486]

As to judicial review, the courts applying *Hudspeth* have assumed that the standards articulated by the APA[487] apply. The exact scope of review is probably governed by the "arbitrary and capricious" standard.[488]

a. Adjudicatory procedure. Must the receiver follow the formal adjudicative procedures of the APA? These are triggered only in the case of "adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved . . . a matter subject to a subsequent trial of law and the facts de novo in a court."[489] Assuming the FSLIC is correct in asserting that creditors are not entitled to de novo judicial determination of the validity of their claims, we need to examine the statutory wording of the FSLIC's adjudicative authority in order to determine whether formal APA proceedings are triggered.

The FSLIC relies on section 1729(d) for authority to adjudicate creditor claims. Subsection 1729(d) contains no obvious terminology to trigger the APA's requirements for formal adjudication.[490] There is no provision for an "agency hearing," nor is there a requirement that the determination be made "on the record." The Supreme Court has insisted upon a literal or very clear triggering in the analogous case of formal rulemaking[491] and, although it appears that the courts might be more willing to construe a requirement of formal procedures in the case of adjudication,[492] the complete absence in section 1729(d) of any reference to the form of procedure to be followed strongly suggests that formal proceedings are not contemplated; on the contrary, the words "settle, compromise, or release," and the preference for informal negotiation and settlement on the part of thrift receivers,[493] suggest that the receiver is not intended to be straightjacketed by formal adjudicative requirements.

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[486] *See infra* notes 608-15 and accompanying text.

[487] 5 U.S.C. § 706.

[488] *See id.* § 706(2)(A).

[489] *Id.* § 554(a)(1).

[490] *See supra* text accompanying note 186 (quoting § 1729(d) in full).

[491] *See* United States v. Florida East Coast Ry., 410 U.S. 224 (1973); United States v. Allegheny-Ludlum Steel Corp., 406 U.S. 742 (1972).

[492] *See* Seacoast Anti-Pollution League v. Costle, 572 F.2d 872 (1st Cir.) (holding formal adjudication proceedings applicable under statute that did not contain words "on the record," but did require the decision to be made "after opportunity for public hearing"), *cert. denied*, 439 U.S. 824 (1978). *But cf.* United States Lines, Inc. v. Federal Maritime Comm'n, 584 F.2d 519, 536 (D.C. Cir. 1978) (holding that, in the absence of a requirement that a hearing be conducted "on the record," no formal adjudication was required by a statute that mandated "notice and hearing").

Furthermore, the FHLBB has located the real adjudication of creditor claims above the level of the receiver.[494] In doing so it must be relying upon its rulemaking authority under section 1464(d)(11),[495] which itself contains no triggering terminology.[496] Hence we can conclude that the procedural provisions of the APA are triggered by neither the FSLIC's adjudicative authority nor the FHLBB's rulemaking authority.[497]

b. Judicial review. The Home Owners' Loan Act and the National Housing Act are silent on the applicable scope of judicial review of the receiver's claims determinations. When endorsing the FSLIC's claim to exclusive adjudicatory jurisdiction, the court in *Hudspeth* noted that once the administrative process has been exhausted the claimant, "if unsatisfied, can seek judicial review under the APA."[498] In fact, none of the courts that have applied the *Hudspeth* doctrine have carefully analyzed the exact nature of this assumed review jurisdiction.[499]

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[493] *See supra* text accompanying note 250.

[494] *See supra* text accompanying notes 278-97.

[495] *See supra* text accompanying notes 427-29.

[496] *See supra* text accompanying note 187 (quoting section 1464(d)(11) in full). In its proposed, interim and supplemental rules, *see supra* notes 201, 202, 205, the Board has relied variously on sections 1437 (which establishes the FHLBB and states its general regulatory mission), 1464(a) (which confers on the FHLBB its general chartering and supervisory powers), 1464(d)(ii) and 1729(d). *See* 53 Fed. Reg. 21,474, 21,475 (1988); 53 Fed. Reg. 13,105, 13,106 (1988); 50 Fed. Reg. 48,970, 48,971 (1985).

[497] Another possible trigger is the Constitution's due process clause. U.S. Const. amend. V. The isolated precedent for this is Wong Yang Sung v. McGrath, 339 U.S. 33 (1950), in which the Court held that the APA's requirement of formal adjudication was triggered if the hearings held by the agency (in this case, on deportation) were held "by compulsion" as opposed to "by regulation, rule, custom, or special dispensation." *Id.* at 50. This suggests that the FHLBB and FSLIC should conduct formal adjudicatory hearings. The trouble is that *Wong Yang Sung* is an unclear guide as to when the Constitution might trigger formal proceedings; moreover, it appears to have little precedential force, at least where personal liberty is not at stake. *Cf.* Clardy v. Levi, 545 F.2d 1241 (9th Cir. 1976) (refusing to extend the reasoning in *Wong Yang Sung* to prison disciplinary proceedings). As the authors of a leading casebook have observed, "[i]n practice . . . *Wong Yang Sung* appears to have fallen into obscurity." W. Gellhorn, C. Byse, P. Strauss, T. Rakoff & R. Schotland, Administrative Law 247 (8th ed. 1987); *cf.* S. Breyer & R. Stewart, Administrative Law and Regulatory Policy 870 (2d ed. 1985); R. Pierce, S. Shapiro & P. Verkuil, Administrative Law and Process § 6.4 (1985).

[498] *Hudspeth, supra* note 103, 756 F.2d at 1103 (citing First Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 531 F. Supp. 251, 254 (D. Haw. 1981) (stating that judicial review "may be available under section 10 of the Administrative Procedure Act, 5 U.S.C. §§ 701-706 (1976)")).

[499] More attention has been paid to the scope of review involved in judicial challenges to the appointment of conservators and receivers. In this context, judicial review is specifically provided for by the statute, 12 U.S.C. § 1464(d)(6)(A) (1982), which uses the phrase "upon the merits." *See, e.g.*, Woods v. FHLBB, 826 F.2d 1400, 1406-09 (5th Cir. 1987) (asserting that Congress did not

The Ninth Circuit, in *Morrison-Knudsen,* took the view that, "[i]n the absence of specific congressional direction," the "arbitrary and capricious" standard "might well be applicable . . . or at best the 'substantial evidence' standard," which the court took to be more deferential than "weight of the evidence" review.[500] Similarly, the Texas court of appeals in *Glen Ridge,*[501] ruling section 1729(d) to be an unconstitutional grant of adjudicative power partly because of the low level of judicial scrutiny on review, observed that neither of the APA's potentially applicable "arbitrary and capricious"[502] or "substantial evidence"[503] standards were as intense as the common law "weight of the evidence" or de novo review standards.[504]

Since *Hudspeth* adjudications are not required by statute to be made "after a hearing on the record,"[505] the scope of review is governed by the "arbitrary and capricious" standard of review and not the "substantial evidence" standard. This would follow from the express statement in the APA that the "substantial evidence" standard should only apply "in a case subject to sections 556 and 557 of this title [i.e., formal adjudication] or otherwise reviewed on the record of an agency hearing provided by statute."[506] In practice, however, because the FHLBB has developed a recordkeeping requirement for *Hudspeth* adjudications,[507] and, with the development of "hard look" review,[508] the scope of review is likely to be as probing under the "arbitrary and capricious" standard as it would

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intend for the district court to review the Bank Board's decision de novo, but rather that the decision be reviewed on the basis of the administrative record in accordance with the APA's "arbitrary and capricious" standard), *cert. denied,* 108 S. Ct. 1221 (1988).

[500] 811 F.2d 1209, 1221 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[501] Glen Ridge I Condominiums, Ltd. v. FSLIC, 734 S.W.2d 374 (Tex. Ct. App. 1986), *writ denied,* 750 S.W.2d 757 (Tex. 1988).

[502] 5 U.S.C. § 706(2)(A) (1982).

[503] 5 U.S.C. § 706(2)(E).

[504] 734 S.W.2d at 380, 389. The district court in *Lyons* relied on legislative history in assuming that the standard of review intended by Congress is actually the "weight of the evidence" standard. *See* Lyons Sav. & Loan Ass'n v. Westside Bancorporation, 636 F. Supp. 576, 580 (N.D. Ill. 1986) (quoting H. REP. NO. 2077, *supra* note 402, at 6), *aff'd,* 828 F.2d 387 (7th Cir. 1987); *accord* Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104, 1107-08 (D. Kan. 1988). But *Lyons* is wrong in two respects. First, the legislative history referred to by the court related to a specific "weight of the evidence" provision in the House bill, whereas the Senate bill, which merely adopted the provisions of the APA, contained the review provisions that Congress eventually enacted. Second, in the legislative history cited by the *Lyons* court, the House committee was concerned only with the special adjudicatory procedures it had established in relation to cease and desist orders and appointment and removal of directors. *See supra* note 402.

[505] *See supra* text accompanying notes 489-93.

[506] 5 U.S.C. § 706(2)(E).

[507] *See supra* text accompanying notes 262-69.

[508] *See generally, e.g.,* R. PIERCE, S. SHAPIRO & P. VERKUIL, *supra* note 497, § 7.5, at 377-88.

have been under the "substantial evidence" standard.[509]

B. *Constitutional Constraints.*

Even if there is statutory authority for the *Hudspeth* scheme, the scheme will be invalid if it violates the Constitution. On the other hand, this article considers not only whether the existing scheme might violate the Constitution, but also with whether, if so, it can be modified so as to comply with the Constitution. If the scheme violates article III, for example, we should then consider whether there is a way in which the procedures might be structured so as to comply with its requirements. If there is not, then the FHLBB and the FSLIC must accept that the validity of creditor claims simply cannot be adjudicated administratively without judicial participation.

1. *Constitutionalism in the Administrative State.* The task of reconciling agency government with the constraints imposed by the Constitution has proven perplexing and recurrent. Something of a pattern has emerged during the course of the past six decades. The Supreme Court has first reacted against the presence of agency authority by vigorously reasserting formal constitutional doctrines. Then, perceiving that it has overreacted and thereby placed the orderly functioning of modern government in jeopardy, it has assumed a more pragmatic or "functional" approach that has ultimately rendered the formal doctrine virtually dormant.[510]

This pattern of resistance, followed by acquiescence, has manifested itself in various contexts. The "constitutional fact"[511] and "jurisdictional fact"[512] doctrines, which once appeared to create insuperable obstacles to exclusive administrative decisionmaking, seem long moribund.[513] The nondelegation doctrine, which wrought such havoc with the first phase of the New Deal,[514] now functions as no more than a docile admonition against the expansive delegation of statutory power to agencies.[515] The restraints imposed upon agency adjudication by article III quite recently seemed formidable; yet, even at a time when the Court has taken an unusually strict view of the Constitution in its application to the first branch of government,[516] article III has subsequently proved remarkably flexible.[517] The application of procedural due process to agencies has evolved into ad hoc judicial judgments as to the fairness of specific procedures.[518]

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[509] *See* Association of Data Processing Serv. Orgs. v. Board of Governors, 745 F.2d 677, 681-86 (D.C. Cir. 1984). In *Data Processing*, Judge Scalia reasoned that the difference between the two standards was related not to the level of rationality that must be exhibited by an agency's decision, but to the material that may be considered by the court in its review: formal adjudications must be judged solely by the closed record that the agency was required to develop. Apart from this, the distinction between the standards is "largely semantic." *See also* R. PIERCE, S. SHAPIRO & P. VERKUIL, *supra* note 497, § 7.3.3.

It is recommended, however, that judicial review be confined to the record, and therefore elevated to the "substantial evidence" standard, because of the fact-specific nature of creditor claims. *See infra* text accompanying note 748.

[510] *Cf.* Rabin, *Federal Regulation in Historical Perspective*, 38 STAN. L. REV. 1189 (1986) (examining the dominant themes that emerge from an overview of the evolution of the federal regulatory system and the judicial response to each successive wave of regulatory change).

[511] *See, e.g.*, Ohio Valley Water Co. v. Ben Avon Borough, 253 U.S. 287 (1920).

[512] *See, e.g.*, Crowell v. Benson, 285 U.S. 22 (1932).

[513] *See generally, e.g.*, R. PIERCE, S. SHAPIRO & P. VERKUIL, *supra* note 497, § 5.2.2 (discussing the demise of the *Ben Avon* and *Crowell* doctrines).

In relevant respects, the Court appears to have shifted from a formalistic approach to a functional one. When deciding on the constitutionality of administrative institutions and schemes, the Court has adopted an interest-balancing approach.[519] The new approach has made it necessary to attempt to predict the likely outcome of constitutional challenges by anticipating which interests the Court is likely to take into account when performing its balancing exercise, as well as the relative weight that each interest will receive. The results are likely to be heavily dependent on the facts in each type of case.

2. *The Network of Constraints.*

a. Delegation of powers. The power to adjudicate creditor claims could be challenged as an unconstitutional delegation on two levels. First, the basic authority to establish the claims determination scheme might be attacked as an unconstitutional delegation of power to the FHLBB. Alternatively, it might be claimed that, when adjudicating creditor claims, the FHLBB and the FSLIC exercise a standardless discretion and that this constitutes an unlawful delegation of power by Congress. The courts in which the delegation issue has been raised have not clearly distinguished between these two potential objections.[520]

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[514] *See* Carter v. Carter Coal Co., 298 U.S. 238 (1936); A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935); Panama Refining Co. v. Ryan, 293 U.S. 388 (1935). *See generally, e.g.*, R. PIERCE, S. SHAPIRO & P. VERKUIL, *supra* note 497, § 3.4.2 (discussing the New Deal cases).

[515] *See infra* notes 522-24 and accompanying text.

[516] *See, e.g.*, Bowsher v. Synar, 478 U.S. 714 (1986); INS v. Chadha, 462 U.S. 919 (1983); Buckley v. Valeo, 424 U.S. 1 (1976).

[517] *Cf.* Bruff, *On the Constitutional Status of the Administrative Agencies*, 36 AM. U.L. REV. 491, 502-04 (1987); Strauss, *Formal and Functional Approaches to Separation-of-Powers Questions—A Foolish Inconsistency?*, 72 CORNELL L. REV. 488 (1987).

[518] *See infra* notes 609-10 and accompanying text.

[519] *See, e.g.*, Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986) (discussed *infra* in text accompanying notes 576-88). *See generally* Aleinikoff, *Constitutional Law in the Age of Balancing*, 96 YALE L.J. 943 (1987).

The entire *Hudspeth* scheme has been implemented as part of the Board's general regulatory authority under 12 U.S.C. section 1464(d)(11).[521] Broad though this regulatory authority is, however, an attack upon its constitutionality has probably long been obviated by *Fahey v. Mallonee*,[522] in which such a challenge, made against the FHLBB's original authority to make rules governing thrift liquidations,[523] was unsuccessful. The Court held that broad legislation enacted within the context of close and experienced regulation does not constitute an unconstitutional delegation of power:

> The remedies which are authorized are not new ones unknown to existing law to be invented by the Board in exercise of a lawless range of power. Banking is one of the longest regulated and most closely supervised of public callings. It is one in which accumulated experience of supervisors, acting for many states under various statutes, has established well-defined practices for the appointment of conservators, receivers and liquidators. Corporate management is a field, too, in which courts have experience and many precedents have crystallized into well-known and generally acceptable standards. A discretion to make regulations to guide supervisory action in such matters may be constitutionally permissible while it might not be allowable to authorize creation of new crimes in uncharted fields.[524]

Although *Fahey* was concerned with the appointment of a conservator, the Court's ruling on the constitutionality of the FHLBB's regulatory authority is probably dispositive in the present context as well, and has been so regarded by those district courts that have been presented with this issue.[525]

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[520] *See, e.g.*, Baer v. Abel, 648 F. Supp. 69, 78 (W.D. Wash. 1986); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93, 100 (W.D. Wash. 1986); American Fed. Sav. & Loan Ass'n v. Westside Fed. Sav. & Loan Ass'n, No. C-85-323-C, slip op. (W.D. Wash. Feb. 4, 1986), *reprinted in* Stevenson Petition, *supra* note 142, at 48a-49a, *rev'd*, Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451).

[521] 12 U.S.C.A. § 1464(d)(11) (West Supp. 1988); *see supra* text accompanying note 187 (quoting § 1464(d)(11) in full).

[522] 332 U.S. 245 (1947).

[523] *See supra* text accompanying note 366. Congress has subsequently addressed the scope of this regulatory authority more specifically. *See* 12 U.S.C.A. § 1464(d)(11) (West Supp. 1988) (FHLBB may regulate thrift liquidations); *see also supra* text accompanying notes 404-06.

[524] 332 U.S. at 250. *Fahey* represents one of the Court's first attempts to pull back from its enforcement of the nondelegation doctrine established in Panama Refining Co. v. Ryan, 293 U.S. 388 (1935), and A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495 (1935). The Court was able to distinguish both cases easily. The Board's regulatory authority did not entail "a power to make federal crimes of acts that never had been such before," it did not enable the Board "to devise novel rules of law in a field in which there had been no settled law or custom," and it did not involve the delegation of governmental power "to private groups as well as to public authorities." *Fahey*, 332 U.S. at 249. On the contrary, the provisions were "regulatory," dealing "with a single type of enterprise and with the problems of insecurity and mismanagement that are as old as banking enterprise." *Id.* at 250.

The second line of attack seems equally futile and perhaps even misconceived. The argument here is that the adjudicatory power assertedly conferred by section 1729(d) is standardless. This objection has some credibility as a result of the decision in *Thomas v. Union Carbide Agricultural Products Co.*,[526] in which nondelegation and article III challenges were mounted against the Environmental Protection Agency's arbitral jurisdiction under the Federal Insecticide, Fungicide, and Rodenticide Act.[527] The appellees had argued that the Act's standard for compensation was so vague as to give "a significant case-by-case lawmaking function to the arbitrator in compensation disputes"[528] and that this represented an unconstitutional delegation of legislative powers. While noting that the legislation, which "appears vague on its face[,] 'may derive much meaningful content from the purpose of the Act, its factual background, and the statutory context,' "[529] and that the legislative history of the legislation was "far from silent,"[530] the Court left the issue open for determination on remand.

Apparently confronted by a similar argument in the present context, one district court has assumed, citing *Union Carbide*, that the nondelegation challenge is "inapposite"[531] since it more appropriately invokes article III than article I.[532] Nevertheless, the success of such a challenge would depend upon the absence of any regulatory tradition, guiding case law, or meaningful judicial review.[533] The availability now of a growing body of published reports on *Hudspeth* adjudications[534] tends to undermine the argument that there are no adjudicatory standards. In any event it is highly unlikely, given the reluctance of the Court to invoke the nondelegation doctrine, that such a challenge would succeed.[535]

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[525] *See, e.g.*, Baer v. Abel, 648 F. Supp. 69, 78 (W.D. Wash. 1986); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93, 100 (W.D. Wash. 1986); American Fed. Sav. & Loan Ass'n, No. C-85-323-C, *reprinted in* Stevenson Petition, *supra* note 142, at 50a.

[526] 473 U.S. 568 (1985).

[527] 7 U.S.C. §§ 136, 136a-136y (1982 & Supp. IV 1986).

[528] 473 U.S. at 601-02 (Brennan, J., concurring).

[529] *Id.* at 593 (quoting American Power & Light Co. v. SEC, 329 U.S. 90, 104 (1946) (as modified)).

[530] *Id.*

[531] First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93, 100 (W.D. Wash. 1986); *see also* American Fed. Sav. & Loan Ass'n, No. C-85-323-C, *reprinted in* Stevenson Petition, *supra* note 142, at 48a-49a.

[532] The court wrongly assumed that *Union Carbide* was concerned with an article III challenge alone, whereas in fact the Court in *Union Carbide* explicitly dealt with the nondelegation challenge. *See Union Carbide*, 473 U.S. at 593 ("Appellees raise article I as an alternative ground for sustaining the judgment . . . .").

[533] *See, e.g.*, Amalgamated Meat Cutters v. Connally, 337 F. Supp. 737, 746, 759-62 (D.D.C. 1971) (agency development of standards that facilitate public accountability and meaningful judicial review saves broad delegation of power).

[534] *See infra* text accompanying note 705.

On the other hand, one of the trade-offs for tolerating broad delegations of power has been the intensification of judicial review;[536] hence the article I objection, even if unsuccessful in itself, might serve to buttress arguments in favor of formal adjudicatory structures and the maintenance of a reliable record for the purposes of judicial review.[537]

b. Article III. The major constitutional objection to the *Hudspeth* scheme so far is the charge that it violates the right of creditors to adjudication of their claims by an independent judiciary enjoying security of tenure and salary, as guaranteed by article III.[538] This complaint played a decisive role, albeit in different ways, in *Morrison-Knudsen*[539] and in *Glen Ridge.*[540] In both cases the courts were aware of the recent Supreme Court applications of article III to administrative agencies.[541] Article III was also relied upon, without success, by litigants in some of the other cases,[542] including *Hudspeth* itself.[543] The issue is now before the Supreme Court.[544]

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[535] As Professor Strauss has put it, "delegation arguments are desperation arguments in the current legal climate." Strauss, *supra* note 517, at 525.

[536] *See, e.g.*, Bowen v. American Hosp. Ass'n, 476 U.S. 610 (1986). In *Bowen*, Justice Stevens explained that "hard look" judicial review is necessary because

> our recognition of Congress' need to vest administrative agencies with ample power to assist in the difficult task of governing a vast and complex industrial Nation carries with it the correlative responsibility of the agency to explain the rationale and factual basis for its decision, even though we show respect for the agency's judgment in both.

Id. at 627; *see also* Ethyl Corp. v. EPA, 541 F.2d 1 (D.C. Cir.) (en banc), *cert. denied,* 426 U.S. 941 (1976). The *Ethyl* court held:

> In the case of legislative enactments, the sole responsibility of the courts is constitutional due process review. In the case of agency decision-making the courts have an additional responsibility set by Congress. Congress has been willing to delegate its legislative powers broadly—and the courts have upheld such delegation—because there is court review to assure that the agency exercises the delegated power within statutory limits, and that it fleshes out objectives within those limits by an administration that is not irrational or discriminatory. Nor is that envisioned judicial role ephemeral, as *Overton Park* makes clear.

Id. at 68 (Leventhal, J., concurring) (citation omitted).

[537] *See infra* text accompanying notes 681-84.

[538] "The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office." U.S. CONST. art. III, § 1.

[539] 811 F.2d 1209 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); *see supra* text accompanying notes 124-31.

[540] 750 S.W.2d 757 (Tex. 1988) (per curiam); *see supra* text accompanying notes 135-40.

[541] Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986); Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568 (1985); Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982) (discussed *infra* in text accompanying notes 545-88).

[542] *See infra* text accompanying notes 545-88.

[543] *See supra* note 107.

[544] *See supra* note 18. It has long been settled that the discretionary power to place a financial institution in receivership and appoint receivers, as opposed to the power to determine the validity of

(i) The evolution of an article III balancing test. After being unexpectedly rejuvenated as a formidable constraint on agency adjudicative power in the early 1980s, article III has, since 1985 and with the emergence of a pragmatic majority in the Court, again lost much of its constraining force.[545] *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[546] was the case in which a plurality of the Court[547] gave the article its unexpected vitality; it was also the case in which the dissent[548] espoused the pragmatic view that has subsequently attracted a majority in the Court.

In *Northern Pipeline* the Court declared unconstitutional a grant of jurisdiction over all civil proceedings arising under title 11 or arising in or related to cases under title 11 of the 1978 Bankruptcy Act.[549] This jurisdiction had been vested in bankruptcy judges who enjoyed neither life tenure nor protection from diminution of salary, both of which are required by article III. Justice Brennan, speaking for the plurality, held that the bankruptcy jurisdiction violated article III for two reasons. First, it did not fall within one of the three established exceptions recognized by the Court in its article III jurisprudence.[550] Second, bankruptcy judges could not be regarded as mere "adjuncts" of article III courts.

In Justice Brennan's view, the only conceivably relevant exception to the application of article III was the enigmatic "public rights" exception: if the subject matter of bankruptcy court jurisdiction involved so-called "public," as opposed to "private," rights, then article III would not apply.[551] But, while Justice Brennan accepted that the restructuring

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individual creditor claims, may be vested by statute in an agency without violating article III. *E.g.*, Bushnell v. Leland, 164 U.S. 684, 685 (1897).

[545] For a critical analysis of the shift toward pragmatism in the Court's application of article III to administrative agencies, see Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916 (1988).

[546] 458 U.S. 50 (1982) (plurality opinion).

[547] Brennan, J., joined by Marshall, Blackmun & Stevens, JJ.

[548] White, J., joined by Burger, C.J. & Powell, J., dissented.

[549] 458 U.S. at 84-85 (plurality opinion). It is important to note that the *Northern Pipeline* holding extended only to the jurisdiction to adjudicate "traditional" state common law actions "not made subject to a federal rule of decision, and related only peripherally to an adjudication of bankruptcy under federal law." *Id.* at 92 (Burger, C.J., dissenting); *see also id.* at 90 (Rehnquist, J., concurring) (characterizing the suit in question (damages for breach of contract, misrepresentation) as "the stuff of the traditional actions at common law").

[550] The exceptions identified by Justice Brennan were those relating to territorial courts, courts-martial, and the adjudication of "public rights." *See id.* at 64-67 (plurality opinion).

[551] *Id.* at 69-70 (plurality opinion). Justice Brennan, recognizing the uncertain distinction between "public rights" and "private rights," referred to Crowell v. Benson, 285 U.S. 22 (1932), in which examples of "public rights" were given. Such rights involved the "exercise of the congressional power as to interstate and foreign commerce, taxation, immigration, the public lands, public health, the facilities of the post office, pensions and payments to veterans." *Crowell*, 285 U.S. at 51 (plurality opinion). For a comprehensive review of the development of the problematic public

of debtor-creditor relations itself "may well be a 'public right,'" public rights "obviously" did not include "state-created private rights, such as the right to recover contract damages."[552] Justice Brennan also declined the invitation to recognize bankruptcy jurisdiction as a special new exception. Bankruptcy judges had jurisdiction over too broad a range of questions, and the creation of further exceptions would erode the protection of article III. "Ad hoc balancing" was to be eschewed.[553]

As to the possible "adjunct" status of bankruptcy courts, the plurality believed that to possess this status the adjudicative scheme had to involve "congressionally created rights,"[554] and that "the functions of the adjunct must be limited in such a way that 'the essential attributes' of judicial power are retained in the article III court."[555] Bankruptcy judges, however, had been given jurisdiction over all civil proceedings related to title 11 cases, they issued final, binding and enforceable judgments, and they were subject only to the deferential "clearly erroneous" standard of review. Hence, too many attributes of judicial power had been transferred to their hands.[556]

Justice White's dissent focused on the impracticality of trying to separate state and federal law claims in bankruptcy proceedings,[557] and on the poverty of the "public rights/private rights" distinction.[558] Justice White instead advocated a pragmatic balancing approach, involving a weighing of the interest of Congress in "pursuing in this manner one of its constitutionally assigned responsibilities" against the values preserved by article III, with the Court retaining "the final word on how that balance is to be struck."[559]

Justice White also adverted to an associated factor that is important for present purposes: namely, the interrelationship of article III with the due process clause. In his view, if a situation were to arise in which Congress might be tempted to influence the article I court, the due pro-

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rights/private rights distinction, see Young, *Public Rights and the Federal Judicial Power: From* Murray's Lessee *Through* Crowell *to* Schor, 35 BUFFALO L. REV. 765 (1986).

[552] 458 U.S. at 71.

[553] *See id.* at 72-74 & n.28.

[554] *Id.* at 78. The relationship, if any, between "public" rights and "congressionally created" rights was not explained.

[555] *Id.* at 81. For example, in Crowell v. Benson, 285 U.S. 22 (1932), where the Court had treated a workers' compensation commissioner as an "adjunct," the Court retained full authority to deal with matters of law.

[556] *See* 458 U.S. at 84-86.

[557] *See id.* at 96-98 (White, J., dissenting).

[558] *See id.* at 107-10.

[559] *See id.* at 113-16.

cess clause itself might then dictate the use of an article III court.[560]

The subsequent article III decisions, *Thomas v. Union Carbide Agricultural Products Co.*[561] and *Commodity Futures Trading Commission v. Schor,*[562] represent a major drift by a clear majority of the Court toward the position advocated in Justice White's *Northern Pipeline* dissent.

In *Union Carbide* an arbitration scheme established by the Environmental Protection Agency for the purpose of compensating the suppliers of data for use in subsequent registration proceedings was challenged. The scheme was compulsory and provided for judicial review only where the arbitrator's decision was alleged to be the result of "fraud, misrepresentation, or other misconduct."

The emphasis of the Court[563] was upon the impossibility of applying article III in an absolute fashion and the consequent need to focus instead on the underlying *policies* of the article: the maintenance of judicial *independence* and *impartiality.*[564] Turning to the "public rights/private rights" analysis employed by the *Northern Pipeline* plurality, the Court noted that the "public rights/private rights" analysis had failed to command majority support[565] and emphasized the pragmatic nature of any test to be applied in the application of article III: "practical attention to substance rather than doctrinaire reliance on formal categories should inform application of article III."[566] Neither the extent of judicial review nor the identity of the parties should, on their own, function as determinative factors.[567]

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[560] *Id.* at 117 (citing Crowell v. Benson, 285 U.S. 22, 87 (1932). In *Crowell,* Justice Brandeis had said, in dissent:

> If there be any controversy to which the judicial power extends that may not be subjected to the conclusive determination of administrative bodies or federal legislative courts, it is not because of any prohibition against the dimunition of the federal district courts as such, but because, under the circumstances, the constitutional requirement of due process is a requirement of judicial process.

Crowell, 285 U.S. at 87.

On the other hand, this does not necessarily dictate de novo judicial review, since, as Justice Brandeis had also observed in a later case:

> The inexorable safeguard which the due process clause assures is not that a court may examine whether the findings [of fact] are correct, but that the trier of the facts shall be an impartial tribunal; that no finding shall be made except on due notice and opportunity to be heard; that the procedure at the hearing shall be consistent with the essentials of a fair trial; and that it shall be conducted in such a way that there will be opportunity for a court to determine whether the applicable rules of law and procedure were observed.

St. Joseph Stock Yards Co. v. United States, 298 U.S. 38, 73 (1936) (Brandeis, J., concurring).

[561] 473 U.S. 568 (1985).

[562] 478 U.S. 833 (1986).

[563] O'Connor, J., wrote for the majority.

[564] *See* 473 U.S. at 582-83.

[565] *See id.* at 586.

[566] *Id.* at 587.

> In essence, the public rights doctrine reflects simply a pragmatic understanding that when Congress selects a quasi-judicial method of resolving matters that "could be conclusively determined by the Executive and Legislative Branches," the danger of encroaching on the judicial powers is reduced.

Id. at 589 (citing Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 68 (1982)).

Turning to the case at hand, Justice O'Connor articulated a number of factors that, in combination, indicated that there had been no violation of article III. First, compensable use of the registrants' data "serves a public purpose as an integral part of a program safeguarding the public health," and in this respect the right to compensation bore "many of the characteristics of a 'public' right."[568] Second, the scheme represented "a pragmatic solution to the difficult problem of spreading the costs of generating adequate information regarding the safety, health, and environmental impact of a potentially dangerous product," one that did "not diminish the likelihood of impartial decisionmaking."[569] Third, given "the nature of the right at issue and the concerns motivating the Legislature," and in view of the "obvious purpose of the legislation to furnish a prompt, continuous, expert and inexpensive method for dealing with a class of questions of fact that are peculiarly suited to examination and determination by an administrative agency specially assigned to that task,"[570] the Court did "not think this system threatens the independent role of the Judiciary in our constitutional scheme."[571] Fourth, the scheme incorporated "its own system of internal sanctions," relying only tangentially upon the judicial branch for enforcement; in such cases the danger of Congressional or Executive encroachment was at a minimum.[572] Finally, there was some judicial review, "including whatever review is independently required by due process considerations."[573] The combination of these factors led the Court to conclude that:

> Congress, acting for a valid legislative purpose pursuant to its constitutional powers under Article I, may create a seemingly "private" right that is so closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary. To hold otherwise would be to erect a rigid and formalistic restraint on the ability of Congress to adopt innovative measures such as negotiation and arbitration with respect to rights created by a regulatory scheme.[574]

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[567] *See id.* at 587-89.

[568] *Id.* at 589.

[569] *Id.* at 590.

[570] *Id.* (quoting Crowell v. Benson, 285 U.S. 22, 46 (1932)).

[571] *Id.*

[572] *Id.* at 591.

[573] *Id.* at 592-93. In this regard Justice O'Connor somewhat vaguely referred to "review of constitutional error," to the constitutional fact doctrine mentioned, equally vaguely, by Chief Justice Hughes in *Crowell,* 285 U.S. at 46, and to Justice Brandeis' dissent in *Crowell,* 285 U.S. at 87 (quoted *supra* note 559).

[574] *Id.* at 593-94.

Although eight Justices agreed that the arbitral scheme did not violate article III, the number supporting the "public rights/private rights" analysis had dwindled to three.[575] In the next case, *Commodity Futures Trading Commission v. Schor,*[576] the balancing approach attracted the concurrence of Justice Stevens as well and was therefore embraced by an even greater majority of the Court.[577]

Schor involved agency adjudication of a state-law counterclaim and hence, unlike *Union Carbide*, where the claim was based on federal law, involved claims that fell squarely within the zone of "private rights" identified by the *Northern Pipeline* plurality. Justice O'Connor reiterated that "practical attention to substance rather than doctrinaire reliance on formal categories should inform application of Article III,"[578] and that "bright line rules cannot effectively be employed to yield broad principles applicable in all Article III inquiries."[579] The constitutionality of the adjudicative scheme should be "assessed by reference to the purposes underlying the requirements of Article III," namely, the preservation of the independence of the judiciary and assurance of an impartial adjudicator in specific disputes.[580] A pragmatic judgment had to be made, one that involves weighing "a number of factors, none of which has been deemed determinative, with an eye to the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary."[581] More specifically, the Court articulated four factors to be weighed in the balance:

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[575] Justice Brennan (joined by Justices Marshall and Blackmun) was able to concur by employing his *Northern Pipeline* "public rights/private rights" analysis, concluding that the determinative feature of the claims in *Northern Pipeline* was the fact that they were created by *state law* and hence were clearly private rights protected by article III. *See* 473 U.S. at 597 (Brennan, J., concurring).

The claim in the *Union Carbide* case, on the other hand, involved a public right, since the dispute arose

> in the context of a federal regulatory scheme that virtually occupies the field. . . . Although a compensation dispute under FIFRA ultimately involves a determination of the duty owed one private party by another, at its heart the dispute involves the exercise of authority by a Federal Government arbitrator in the course of administration of FIFRA's comprehensive regulatory scheme. As such it partakes of the characteristics of a standard agency adjudication.

Id. at 600-01 (Brennan, J., concurring). Justice Stevens concurred on other grounds. *Id.* at 602 (Stevens, J., concurring).

[576] 478 U.S. 833 (1986).

[577] Justice O'Connor again gave the opinion of the Court. Justice Brennan, joined by Justice Marshall, was this time forced to dissent.

[578] 478 U.S. at 848 (quoting *Union Carbide,* 473 U.S. at 587).

[579] *Id.* at 857.

[580] *Id.* at 848. The former purpose was primarily structural and nonwaivable, being concerned with the constitutional scheme as a whole, and the latter primarily personal and waivable, being concerned with protecting the immediate parties to litigation. The Court found that Schor had in fact waived this latter right. *See id.* at 849-50.

[581] *Id.* at 851.

> [(i)] the extent to which the "essential attributes of judicial power" are reserved to Article III courts, and, conversely, [(ii)] the extent to which the non-Article III forum exercises the range of jurisdiction and powers normally vested only in Article III courts, [(iii)] the origins and importance of the right to be adjudicated, and [(iv)] the concerns that drove Congress to depart from the requirements of Article III.[582]

Applying this weighing process, Justice O'Connor noted that the jurisdiction to adjudicate common law counterclaims involved only a "single deviation from the agency model,"[583] that the CFTC deals only with a "particularized area of law"[584] that the review of the CFTC by article III courts was closer than in *Northern Pipeline,* and that the range of jurisdiction and powers exercised by the CFTC was much narrower than that of the bankruptcy courts in *Northern Pipeline.*[585] As to the nature of the claim itself, the fact that it fell squarely within the zone of "private rights" was not itself dispositive. Instead, the fact that it was a type of claim that historically would have been adjudicated by article III courts was merely an indication that the danger to the judicial power was greater than would be the case with "public rights."[586] The availability of a parallel article III jurisdiction invokable by the parties ameliorated the significant threat to the judiciary. Finally, the congressional purpose was honorable.[587] Hence "the magnitude of any intrusion on the Judicial Branch can only be termed *de minimis.*"[588]

(ii) Implications for the Hudspeth *procedures.* The Court has thus articulated several factors that have to be weighed before coming to a final judgment on the constitutionality of the *Hudspeth* administrative scheme. The Texas court of appeals in *Glen Ridge*[589] thought that the *Hudspeth* scheme simply fell short of meeting these requirements. The FSLIC failed to satisfy the criteria necessary to be regarded an "adjunct" of the courts.[590] There were insufficient safeguards to justify a departure

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[582] *Id.*

[583] *Id.*

[584] *Id.* (quoting *Northern Pipeline,* 458 U.S. at 85).

[585] *Id.* at 852-53.

[586] *See id.* at 853-54.

[587] "When Congress authorized the CFTC to adjudicate counterclaims, its primary focus was on making effective a specific and limited federal regulatory scheme, not on allocating jurisdiction among federal tribunals. Congress intended to create an inexpensive and expeditious alternative forum . . . ." *Id.* at 855.

[588] *Id.* (emphasis in original).

[589] Glen Ridge I Condominiums, Ltd. v. FSLIC, 734 S.W.2d 374 (Tex. Ct. App. 1986), *aff'd,* 750 S.W.2d 757 (Tex. 1988) (per curiam); *see supra* text accompanying notes 135-40.

[590] *See* 734 S.W.2d at 385-86 (focusing primarily on the executive appointment and creation of FSLIC officers and offices, the absence of supervisory control by article III judges and the narrow scope of judicial review, the absence of contempt powers on the part of the FSLIC, the breadth of subject matter jurisdiction asserted by the FSLIC, and the nonstatutory nature of the rights in issue).

from normal article III requirements. Unlike Schor, creditors have no choice in selecting who will adjudicate their claims.[591] The allocation of powers between the FSLIC and the article III courts is lopsided, with the courts being totally precluded, if section 1464(d)(6)(C) is applicable,[592] from exercising any supervisory review.[593] The limited judicial review recognized in *Hudspeth* is much narrower than had obtained in *Schor.*[594] Finally, whereas in *Schor* the parallel availability of access to the courts had rendered fair the balance that had been struck between a proper respect for traditional "private" rights and the need for their expeditious adjudication, the compulsory preclusion of the courts under the *Hudspeth* doctrine rendered FSLIC adjudication constitutionally impermissible.[595]

To these considerations one might add the fact that in neither *Union Carbide* nor *Schor* was there serious dispute about the intention of Congress. The "concerns motivating the Legislature,"[596] the "obvious purpose of the legislation,"[597] and the explicit authority that Congress had provided to adjudicate counterclaims,[598] were factors specifically relied upon by the Court in adopting the view that a departure from article III was justified. In the *Hudspeth* context, on the other hand, the legislative purpose of Congress is far from evident.[599]

The *Glen Ridge* court of appeals' analysis of the present *Hudspeth* scheme seems fair. Yet the determinative criteria are interdependent in the sense that subtle readjustments to the relevant procedures and structures might well produce a formula that, on balance, would satisfy the cumulative demands of article III. With clear statutory authority, and the provision of safeguards designed to ensure fair, impartial adjudication and adequate judicial supervision, it would be possible for Congress and the FHLBB to construct a constitutionally acceptable administrative claims adjudication scheme.[600]

c. Due process. The *Hudspeth* doctrine has been challenged under the due process clause for failure to provide an adequate hearing,[601] and for violating the principle of an impartial hearing.[602] Both challenges have failed in the lower courts thus far,[603] although it is possible that the Supreme Court will address them.[604] In any event, many judges have only dismissed the due process claims on ripeness grounds, so it is likely that these questions will return to the courts again.

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[591] *See id.* at 388.

[592] *See supra* text accompanying notes 423-25.

[593] 734 S.W.2d at 388-89.

[594] *Id.* at 389.

[595] *Id.* at 389-90.

[596] *See* Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568, 590 (1985); *supra* text accompanying note 570.

[597] *See Thomas,* 473 U.S. at 590 (quoting Crowell v. Benson, 285 U.S. 22, 46 (1932)).

[598] *See supra* text accompanying notes 427-29.

[599] *See supra* text accompanying notes 362-429.

[600] This was recognized by the court in *Morrison-Knudsen. See supra* notes 126-30 and accompanying text.

It is important to distinguish between the two kinds of due process challenge that have been made: the charge that the *Hudspeth* procedures are *inadequate* implicates quite different considerations from those implicated by the charge that the FSLIC suffers from a *conflict of interest* when determining the validity of creditor claims.[605] Another general observation should also be made: as with the nondelegation doctrine and article III jurisprudence, the Court has adopted a pragmatic approach when judging these two facets of due process. The adequacy of administrative procedures is judged by an ad hoc balancing test,[606] and even in cases of alleged conflict of interest the Court has indicated that ad hoc evaluation is necessary in each case.[607]

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[601] *See* FSLIC v. Florida 100 Dev. Group, 670 F. Supp. 1577, 1583 (S.D. Fla. 1987) (no opportunity to present testimony or cross-examine witnesses; claim dismissed as not being ripe); Baer v. Abel, 648 F. Supp. 69, 78 (W.D. Wash. 1986) (no opportunity to cross-examine witnesses or present testimony; claim dismissed as premature).

[602] *See* Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563, 564-5 (5th Cir. 1987) (claim that FSLIC will act as party and judge disposed of by decision in Woods v. FHLBB, 826 F.2d 1400 (5th Cir. 1987), *cert. denied*, 108 S. Ct. 1221 (1988)), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988); *Florida 100 Dev. Group*, 670 F. Supp. at 1583 (due process claim dismissed as not yet ripe); *Baer*, 648 F. Supp. at 78 (due process claim that FSLIC is an interested adjudicator dismissed as premature); First Am. Sav. Bank, F.S.B. v. Westside Fed. Sav. & Loan Ass'n, 639 F. Supp. 93, 99-100 (W.D. Wash. 1986) ("assertion that FSLIC is likely to prefer its own interests over their claims is rebutted by the presumption that FSLIC acts in the best interests of the whole estate"); Modern Supply Co. v. FSLIC, 50 Wash. App. 194, 205, 748 P.2d 251, 257-58 (Wash. Ct. App. 1987) (charge that "it is unfair if the FSLIC is empowered to hear claims where its interests are adverse to the claimant's" rejected because of existence of adequate administrative appeal to FHLBB and recourse to judicial review under APA).

[603] *But cf.* Tocci Corp. v. Yankee Bank for Fin. & Sav., FSB, No. Civ. A. 87-3121-K (D. Mass. 1988) (Westlaw, 1988 WL 70344). The *Tocci* court stated:

> The conclusion[ ] . . . [that the FDIC and FSLIC do not have exclusive jurisdiction to adjudicate creditor claims in savings bank receiverships is] reinforced by the observation that allowing any person or entity to adjudicate claims against itself is an extraordinary arrangement because of the inherent conflict of interest implicit in such a dual role. An interpretation of a statute that attributes to Congress a manifestation of intent to create powers in an agency so likely to lead to impairment of impartiality in adjudication is inherently suspect.

Id.

[604] Certiorari has been granted in one case that presents these issues directly. Coit Independence Joint Venture v. FirstSouth, F.A., 829 F.2d 563 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988) (discussed *supra* at notes 17-18).

[605] This distinction was not drawn by the Fifth Circuit in its decision in *Coit*. *See id.* The court relied on a decision involving the adequacy of a hearing in dismissing Coit's complaint based upon conflict of interest. *Id.* at 565 (referring to *Woods*, 829 F.2d at 1410-13). Quite apart from the relevancy of the *Woods* decision to the statutory context in question (*Woods* involved the procedures governing the appointment of a receiver, whereas the present issue concerns the adjudication, by a validly appointed receiver, of creditor claims), *Woods* did not deal with the question whether the FSLIC's procedures required an impartial adjudicator. *See* Petition for Writ of Certiorari at 19 n.8, Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988) (No. 87-996).

(i) Adequacy of the hearing. Procedural due process, to the extent that it is triggered by the the kinds of claims filed by creditors,[608] may well mandate certain procedural requirements even if the FSLIC's determinations are regarded as a species of informal adjudication. Under the balancing approach articulated by the Court in *Mathews v. Eldridge,*[609] the requirements of procedural due process will vary from case to case, according to the private interest at stake, the efficacy of the existing procedures and the extent to which new procedures will produce more accurate decisions, and the cost to the government in implementing these procedures.[610]

The *Mathews* three-part balancing test has often been criticized; it hardly suggests an obvious answer in each case. Instead, it dictates yet another ad hoc balancing test to determine exactly what an agency is required to do to meet constitutional requirements. Perhaps the most widely accepted set of guidelines are those articulated shortly before the *Mathews* decision by the late Judge Henry Friendly.[611] He thought the following constitute, "roughly in order of priority,"[612] the elements of a fair hearing: an unbiased tribunal; notice of proposed action and the grounds asserted for it; an opportunity to present reasons why the proposed action should not be taken; the right to call witnesses; the right to know the evidence against one; the right to have the decision based only on the evidence presented; the right to counsel; the making of a record; a statement of reasons; public attendance; and judicial review.[613]

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[606] *See infra* notes 609-10 and accompanying text.

[607] *See infra* notes 622, 631-33 and accompanying text.

[608] Claims grounded in contract would represent constitutionally protected property interests, *see, e.g.,* Perry v. Sindermann, 408 U.S. 593, 599-601 (1972) (holding that a person may be deprived of a right created by contract only if due process requirements have been met); Board of Regents v. Roth, 408 U.S. 564, 578 (1972) (holding that the requirements of procedural due process did not apply to teaching appointment that did not create a property interest), but it is not clear whether those grounded in tort would be sufficient to implicate either property or liberty interests. *See, e.g.,* Paul v. Davis, 424 U.S. 693, 712 (1976) (common law defamation does not rise to level of a constitutional cause of action unless it results in a deprivation of "liberty" or "property" recognized by state or federal law). Nor, even if they are, is it clear whether anything more than a right of action in tort is required by due process. *See, e.g.,* Ingraham v. Wright, 430 U.S. 651, 682-83 (1977) (right to bring action in tort deemed sufficient due process). Certainly those based on negligence would not. *See* Davidson v. Cannon, 474 U.S. 344 (1986) (due process protection only implicated where *intentional* government deprivation of protected interests involved); Daniels v. Williams, 474 U.S. 327 (1986) (same).

Given the sweep of the *Hudspeth* doctrine, however, the doctrine's coverage in relation to contractual claims alone justifies evaluation of the *Hudspeth* procedures against due process standards.

[609] 424 U.S. 319 (1976).

[610] *Id.* at 335.

[611] Friendly, *"Some Kind of Hearing,"* 123 U. PA. L. REV. 1267 (1975).

[612] *Id.* at 1278.

Judge Friendly also suggested a hierarchy of adverse governmental action,[614] from most to least severe, that would demand adherence to these procedures to a greater or lesser extent.[615] He ranked decisions such as those involving personal liberty (e.g., parole) at the most severe end of the spectrum, and decisions involving governmental benefits at the least severe end. We can assume he would have placed receivership decisions near the middle of the spectrum, alongside those involving professional and trade licenses. In other words, receivership decisions rank as moderately severe government action, and this would suggest that a substantial proportion of the elements of procedural due process identified by Judge Friendly should be considered in applying the *Mathews* balancing test.

(ii) Impartiality. The agencies administering the *Hudspeth* scheme are subject to two possible conflicts of interest. The first is pecuniary, and the second stems from the receiver's active involvement in both the affairs of the receivership in general and the determination of claims against the receivership.

The FSLIC, in its corporate capacity as insurer of thrift deposits, is nearly always the largest creditor in any thrift receivership. Since the FSLIC is also the receiver, this suggests a serious conflict of interest on the part of the receiver when it is determining the validity of the claims of other creditors. The potential conflict is rendered all the more acute by the current pressure on the insurance fund.[616] Indeed, it is this very financial crisis that is offered as the prime justification for the administrative adjudicatory powers claimed under the *Hudspeth* doctrine.[617] Hence, even if adjudication only takes place at the FHLBB level, the financial pressures might be too great to allow for impartial adjudication.

Since *Dr. Bonham's Case*[618] at least, a financial interest, however small, in the outcome of one's decision has been regarded as a disqualification from decisionmaking.[619] The general proposition was restated in *Tumey v. Ohio*,[620] where Chief Justice Taft observed: "That officers acting in a judicial or quasi judicial capacity are disqualified by their interest in the controversy to be decided is, of course, the general rule."[621] Nevertheless, the Court has always found it necessary to focus upon the "degree or nature of the interest"[622] and this necessarily involves a renewed assessment in each new set of circumstances in which a pecuniary interest is alleged to violate due process.

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[613] *Id.* at 1279-95.

[614] The rejection of a claim filed against a receivership would be "adverse governmental action."

[615] *See id.* at 1295-304.

[616] *See supra* text accompanying notes 81-88.

[617] *See, e.g.*, Morrison-Knudsen Co. v. CHG Int'l, Inc., 811 F.2d 1209, 1216 (9th Cir. 1987), *petition for cert. filed sub nom.* FSLIC v. Stevenson Assocs., 56 U.S.L.W. 3249 (U.S. Sept. 17, 1987) (No. 87-451); Peoples' Sav. & Loan Ass'n v. First Fed. Sav. & Loan Ass'n, 677 F. Supp. 1104, 1108 (D. Kan. 1988); *see also supra* text accompanying notes 91-92.

[618] 8 Coke's Rep. 114a, 77 Eng. Rep. 646 (C.P. 1610).

In *Tumey*, the Court found that the due process clause had been violated for two reasons: first, because a mayor, who was also the judicial officer in cases involving prosecutions for violations of the state prohibition law, would only receive compensation for trying cases from the fines levied upon conviction of the defendants.[623] Second, and more important for our purposes (since there is no suggestion that members of the FHLBB or the FSLIC stand to gain in any personal way from the outcome of decisions made by thrift receivers), the Court found that there was a violation of due process because the legislative scheme had been deliberately constructed so as to "stimulate small municipalities in the country part of counties in which there are large cities, to organize and maintain courts to try persons accused of violations of the Prohibition Act everywhere in the county."[624] In the absence of safeguards such as trial by jury, opportunity for a retrial, or broad judicial review, and given the mayor's inevitable interest "in the financial condition of the village, and his responsibility therefor,"[625] the defendant could justifiably claim that he had been denied due process.

The importance of this second basis for the decision in *Tumey* is illustrated by the Court's more recent decision in *Ward v. Village of Monroeville*.[626] Here the Court held that, even though the mayor-adjudicator did not stand to benefit personally and directly from the outcome of his decisions, the financial benefit to his municipality was so great as to constitute "a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the State and the accused."[627]

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[619] Even the decision of a Lord Chancellor was set aside on this ground. *See* Dimes v. Grand Junction Canal, 3 H.L. Cas. 759, 10 Eng. Rep. 301 (1852). Financial interest should be contrasted with other potential sources of bias, such as prejudgment or generalized hostility; in the latter case it is much more difficult to establish a violation of due process. *See, e.g.*, Aetna Life Ins. Co. v. Lavoie, 475 U.S. 813 (1986) (while a judge's general hostility toward the insurance industry would be insufficient to constitute a violation of due process, the advantage the judge would gain from participating in a decision that would enhance the prospects of success in his own litigation pending in other courts was enough to vitiate the decision).

[620] 273 U.S. 510 (1927).

[621] *Id.* at 522.

[622] *Id.*

[623] *See id.* at 531-32.

[624] *Id.* at 532.

[625] *Id.* at 533.

[626] 409 U.S. 57 (1972).

The fact that both *Tumey* and *Ward* involved criminal prosecutions is not a ground for distinguishing these cases. The Supreme Court has expressly stated that *Tumey* and *Ward* apply with equal force to situations involving administrative adjudication.[628]

A conflict-of-interest objection to the FSLIC acting as both "prosecutor" and "adjudicator" is more difficult to sustain. In *Withrow v. Larkin,*[629] the Court again articulated a pragmatic approach for evaluating complaints that an agency has combined both investigatory and adjudicative functions. Though recognizing that a pecuniary interest is one of those situations "in which experience teaches that the probability of actual bias on the part of the judge or decisionmaker is too high to be constitutionally tolerable,"[630] Justice White noted that the problem of separating investigative from adjudicatory functions had been addressed by Congress in various ways[631] and that "[t]he incredible variety of administrative mechanisms in this country will not yield to any single organizing principle."[632] The test is whether the risk of bias or unfairness is "too high to be constitutionally tolerable."[633]

This pragmatism again requires an evaluation of the actual *Hudspeth* structures and suggests the possibility of devising a scheme that would satisfy constitutional constraints. The strictness with which the Court regards potential pecuniary conflicts of interest indicates that substantial adjudicative independence, and a meaningful separation between the receiver and adjudicator, are minimum requirements.[634] These safeguards would also address the need to prevent a mixing of

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[627] *Id.* at 60 (quoting *Tumey,* 273 U.S. at 532 (1927)). That the Court in *Tumey* expressly extended the basis of its decision beyond the personal financial benefit enjoyed by the mayor was overlooked by Justice White in his dissent in *Ward.*

[628] *See* Gibson v. Berryhill, 411 U.S. 564, 579 (1973).

[629] 421 U.S. 35 (1975).

[630] *Id.* at 47.

[631] One general solution is the APA's requirement in formal adjudications that employees engaged in investigating or prosecuting may not also participate or advise in the adjudication. *See* 5 U.S.C. § 554(d) (1982).

[632] 421 U.S. at 52.

[633] *Id.* at 47.

[634] *See infra* text accompanying notes 700-08. The problem of striking the right balance when creating an internal separation of powers in an agency is perennial, and it requires fine adaptation to the circumstances of each case. *See* Asimow, *When the Curtain Falls: Separation of Functions in the Federal Administrative Agencies,* 81 COLUM. L. REV. 759 (1981).

"prosecutorial," or investigatory, and adjudicative functions. On the other hand, such safeguards are probably also *sufficient* requirements. In *Marshall v. Jerrico, Inc.*,[635] the Court upheld the constitutionality of a scheme in which the Employment Standards Administration was reimbursed for its costs from the civil penalties levied by the Administration on child labor violators. Although the agency benefited financially from the determinations of its assistant regional administrator, no individual within the agency stood to benefit personally[636] and alleged violators were provided with a full, de novo hearing before an independent administrative law judge. This procedure was deemed sufficient to satisfy the neutrality requirements of due process.[637]

d. Seventh amendment. The seventh amendment provides that "[i]n Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved." Many of the claims filed against thrifts in receivership[638] are plainly derived from "suits at common law," or are based upon statutes that have created "legal rights and remedies" normally "enforceable in an action for damages in the ordinary courts of law."[639] Examples of the former are actions for breach of contract, negligent misrepresentation and civil fraud. Examples of the latter are civil RICO claims predicated upon crimes alleged to have been committed by the thrift or its agents. Both types would, in the absence of receivership, be tried to a judge and jury in state or federal courts having jurisdiction.[640]

Hence it is not surprising that creditors challenging the *Hudspeth* doctrine have charged that the doctrine violates their right to a trial by jury. The first reported case in which this challenge was addressed (and rejected) was *Baer v. Abel.*[641] More recently the challenge was raised in

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[635] 446 U.S. 238 (1980).

[636] *Id.* at 250.

[637] *Id.* at 247-50.

[638] *See supra* text accompanying notes 225-37.

[639] Curtis v. Loether, 415 U.S. 189, 194 (1974).

[640] The seventh amendment applies only to federal proceedings. *See* Minneapolis & St. L. R.R. v. Bombolis, 241 U.S. 211 (1916). *See generally* 2 R. ROTUNDA, J. NOWAK & J. YOUNG, TREATISE ON CONSTITUTIONAL LAW 256-58 & n.12 (1986).

[641] 648 F. Supp. 69 (W.D. Wash. 1986). Shareholders had commenced an action against a thrift, alleging violations of federal and state securities laws, RICO, and the Washington State Consumer Protection Act in the sale of the thrift's stock. The thrift was then placed into receivership by the FHLBB, and the FSLIC moved to dismiss the plaintiffs' claims. Judge Rothstein granted the motion, rejecting the charge that in so doing he was denying the plaintiffs their right to trial by jury. He reasoned that the amendment "does not apply in actions against the Federal Government," and that even if the United States had consented to be sued, it had not conceded the right to a jury trial. *Id.* at 77 (quoting Lehman v. Nakshian, 453 U.S. 156, 160 (1981)). Furthermore, the judge reasoned, the Supreme Court "has frequently affirmed congressional authority to commit factfinding

Coit Independence Joint Venture v. FirstSouth, F.A.[642] The Fifth Circuit rejected the seventh amendment challenge in *Coit Independence* as not being ripe,[643] and the question is now before the Supreme Court.[644] It is unlikely, however, that this challenge will be successful, both because the Court has proved tolerant of administrative adjudication with which a jury would be incompatible, and because receivership claims are likely, in any event, to be treated as "equitable."

(i) Supreme Court toleration. The seventh amendment challenge appears, from the jurisprudential history of its application, to depend at least partly on the success of the article III challenge. In other words, if an adjudicative scheme could be devised that was authorized by Congress and satisfied the constraints of article III, it is unlikely that the Court would rule that it remained invalid because it denied the right to a jury trial.

This view is reflected in a recent dictum in *Tull v. United States,*[645] where Justice Brennan remarked that "the Seventh Amendment is not applicable to administrative proceedings."[646] For, although it was once conceded by the Court that the argument that "the right to a jury trial was never intended to depend on the identity of the forum to which Congress has chosen to submit a dispute" was "well put,"[647] the fact is that where Congress has chosen to vest the adjudicative power in the hands of an agency, the Court has refused to apply the seventh amendment.[648] Where, on the other hand, Congress has chosen to place adjudication of

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functions and initial adjudications to an administrative forum without violating the seventh amendment." *Id.* at 77-78 (citing Atlas Roofing Co. v. Occupational Safety & Health Review Comm'n, 430 U.S. 442, 450-55 (1977)).

[642] 829 F.2d 563 (5th Cir. 1987), *cert. granted sub nom.* Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1988).

[643] 829 F.2d at 565.

[644] *See supra* note 18.

[645] 107 S. Ct. 1831 (1987).

[646] *Id.* at 1835 n.4 (echoing prior dicta to the same effect); *see, e.g., Atlas Roofing,* 430 U.S. at 450 ("at least in cases in which 'public rights' are being litigated . . . the Seventh Amendment does not prohibit Congress from assigning the factfinding function and initial adjudication to an administrative forum with which the jury would be incompatible"); Pernell v. Southall Realty, 416 U.S. 363, 383 (1974) ("the Seventh Amendment is generally inapplicable in administrative proceedings where jury trials would be incompatible with the whole concept of administrative adjudication"); *see also* Curtis v. Loether, 415 U.S. 189, 194-95 (1974); L. JAFFE, JUDICIAL CONTROL OF ADMINISTRATIVE ACTION 90 (1965) (observing that, even if to do so would satisfy the Constitution, it would not be feasible to attach juries to agencies because "the concept of expertise on which the administrative agency rests is not consistent with the use by it of a jury as fact finder").

[647] *Atlas Roofing,* 430 U.S. at 457-58.

[648] *See id.* at 460-61; NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 48-49 (1937); Block v. Hirsh, 256 U.S. 135, 158 (1921); *cf.* Katchen v. Landy, 382 U.S. 323, 336-40 (1966) (bankruptcy court).

the rights it has created in the hands of a district court, the Court has proved much more willing to find an infringement of the requirements of the seventh amendment.[649]

Various explanations have been offered for not requiring a jury trial in the case of agency adjudication. In *Block v. Hirsh* the Court thought that if a rent commission's statutory power was clear and constitutional, the seventh amendment objection "amounts to little. To regulate the relation [of landlord and tenant] and to decide the facts affecting it are hardly separable."[650] In *National Labor Relations Board v. Jones & Laughlin Steel Corp.* the Board's power to order reinstatement of an employee and payment for time lost was described as "not a suit at common law or in the nature of such a suit. The proceeding is one unknown to the common law. It is a statutory proceeding" involving the recovery of damages only as "an incident to equitable relief."[651] In *Atlas Roofing Co. v. Occupational Safety & Health Review Commission* the Court relied on the "public rights/private rights" distinction as a justification: the power of the agency to determine violations of safety standards, to issue abatement orders, and to assess civil penalties, was described as involving "public rights" based upon newly created "statutory obligations" and not entailing a right to a jury trial.[652] These arguments probably also apply to an otherwise constitutional administrative claims adjudication scheme.

(ii) Equitable nature of the proceedings. The Court's relaxation of the literal requirements of the seventh amendment has been criticized as "seriously weakening the protection afforded by the seventh amendment."[653] But even if the Court were to adopt a stricter approach it is unlikely that it would do so in the case of thrift receivership adjudications.

In *Katchen v. Landy,*[654] a seventh amendment challenge was made against the summary jurisdiction of a bankruptcy court to order the surrender of voidable preferences asserted and proved by a trustee in response to a claim filed by the creditor who had received the preferences. The Court rejected the challenge, concluding that "there is no Seventh Amendment right to a jury trial for determination of objections to claims."[655] The Bankruptcy Act "converts the creditor's legal claim into an equitable claim to a pro rata share of the *res*" and "the proceedings of bankruptcy courts are inherently proceedings in equity," to which the right to a jury trial does not extend.[656] It is therefore unlikely that the right to a jury trial would extend to the analogous situation of claims adjudications in thrift receiverships.[657]

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[649] *See, e.g.,* Tull v. United States, 107 S. Ct. 1831, 1835-39 (1987); *Pernell,* 416 U.S. at 363; *Curtis,* 415 U.S. at 189.

[650] 256 U.S. at 158.

[651] 301 U.S. at 48.

[652] *See* 430 U.S. at 449-61.

[653] Kirst, *Administrative Penalties and the Civil Jury: The Supreme Court's Assault on the Seventh Amendment,* 126 U. PA. L. REV. 1281, 1281 (1978).

[654] 382 U.S. 323 (1966).

3. *The Importance of Clear Statutory Authority, Standards, Internal Separation of Powers, Procedural Fairness and Adequate Judicial Scrutiny.* The thrift industry is so intensely regulated[658] that the *Hudspeth* scheme might well pass the enigmatic "public rights/private rights" test even though creditors' claims often involve rights created by state law.[659] On the other hand, the *Hudspeth* scheme constitutes a sweeping assertion of jurisdiction over a very broad range of claims[660] and therefore constitutes one of the most daring challenges to article III yet presented.[661] For this reason, Congress, the FHLBB and the FSLIC have to ensure that they take fully into account the cluster of concerns driving current Supreme Court jurisprudence on the constitutionality of agency adjudication.

Though the Court has dictated general deference to agencies in the construction of their statutory powers,[662] it has also relied upon the clarity of congressional purpose when accepting a departure from the requirements of article III.[663] Statutory ambiguity has also explicitly and properly led the courts in *Morrison-Knudsen* and *Glen Ridge* to avoid the constitutional problems by adopting a narrow construction of the agencies' powers.[664] This supports the recommendation that, even if the

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[655] *Id.* at 337.

[656] *See id.* at 336-37.

[657] *Katchen* is something of an exception in a pro-jury line of cases. *See, e.g.*, Ross v. Bernhard, 396 U.S. 531, 538-40 (1970) (emphasizing that the distinction between law and equity is not itself determinative and that a jury trial might be available even where the procedural device employed was originally equitable). Nevertheless, since *Katchen* addresses bankruptcy, which is so closely analogous to financial receiverships, it is likely that the case would control in the present context.

[658] *See supra* text accompanying notes 40-51, 342-419. As the Court once put it, the FHLBB "has promulgated regulations governing 'the powers and operations of every Federal savings and loan association from its cradle to its corporate grave.' " Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta, 458 U.S. 141, 145 (1982) (quoting People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311, 316 (S.D. Cal. 1951)).

[659] *See supra* text accompanying notes 225-37.

[660] *See id.*

[661] *See supra* notes 554-56, 584-85 and accompanying text (emphasizing the breadth of administrative jurisdiction as an important criterion).

[662] *See supra* text accompanying notes 325-36.

[663] *See supra* text accompanying notes 596-98.

[664] *See supra* text accompanying notes 129-31, 135-37.

FHLBB does have putative authority to establish the *Hudspeth* scheme,[665] this authority, and the structure of the adjudicative scheme itself, should be stated in clearer terms by Congress.[666]

The absence of adjudicatory standards raises concern about the excessive delegation of powers[667] and might lead the Court to construe the FHLBB's statutory mandate restrictively. Basic procedural fairness also requires clear notice of the procedures to be followed in determining claims.[668] Together, these concerns suggest not only the publication of opinions arising out of *Hudspeth* adjudications (a practice that the FHLBB has already begun to address[669]) but also the desirability of detailed, final rules governing the detailed processes for creditor claims determinations.[670]

Although it is prepared to evaluate administrative arrangements on an individual basis,[671] the Court is concerned about the availability of an impartial adjudicator[672] and, in particular, potential conflicts of interest, both financial and functional.[673] It is also concerned with the fairness of the adjudicative procedure.[674] These concerns indicate that Congress or, in the absence of congressional action, the FHLBB itself, should ensure that there is a genuine internal separation of powers between the receiver and the claims adjudicator, that the claims adjudicator should enjoy significant insulation from the pressures, both financial and administrative, that might otherwise be brought to bear during the course of a receivership, and that creditors should not be prejudiced by ex parte material not on the record.[675]

With regard to article III, the Court has repeatedly expressed concern that there should be no attempt by Congress to aggrandize itself, through agencies, at the expense of the judicial branch.[676] This militates strongly against the assertion by the FHLBB and the FSLIC that creditor claims that have already been adjudicated by a court should be submitted to the receiver for adjudication de novo.[677] The attempt by an agency not merely to assert primary jurisdiction but to place itself in an appellate position vis-a-vis the courts is surely a flagrant "aggrandizement" of power at the expense of the courts.[678] Furthermore, the notion of a losing party having the opportunity to "readjudicate" the claim against it surely raises the apparent conflict of interest to an intolerable level.[679] The assertion of such jurisdiction therefore seems to go beyond the constitutional limits of administrative adjudication.[680]

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[665] *See supra* text accompanying notes 427-29.

[666] *See infra* text accompanying notes 754-58 (Recommendation 1).

[667] *See supra* text accompanying notes 526-35.

[668] *Cf.* Friendly, *supra* note 611, at 1278 ("more elaborate specification of . . . [desirable procedural safeguards] may help to produce more principled and predictable decisions"). Judge Friendly's set of guidelines are set forth *supra* in text accompanying notes 612-13.

[669] *See infra* text accompanying note 705.

[670] *See infra* text accompanying notes 764-65 (Recommendation 4).

[671] *See supra* text accompanying notes 622, 631-33.

[672] *See supra* text accompanying note 564.

[673] *See supra* text accompanying notes 618-37.

[674] *See supra* text accompanying notes 608-15.

[675] *See infra* text accompanying notes 759-62 (Recommendation 2).

[676] *See supra* text accompanying notes 570-72, 588.

Finally, one consistent concern, arising in the context of the nondelegation doctrine,[681] article III,[682] and due process,[683] is that there be adequate judicial review of agency adjudication. If the administrative adjudication scheme is valid, de novo judicial review would be wastefully duplicative. But meaningful judicial review to guard against abuses of power by the administrative adjudicator is a necessity. This entails the development of a coherent and reliable record and clarification as to the standard of judicial review.[684]

IV. EVALUATION OF THE *HUDSPETH* PROCESS

The basic contention of the FHLBB that an administrative adjudication process is preferable to the regular judicial process, has been accepted as a premise of this article. Yet this contention is itself a matter of controversy. For example, while it seems probable that administrative adjudication would ensure greater uniformity in the case of receiverships that are faced with claims from different judicial jurisdictions, there is no hard evidence to show that the *Hudspeth* process is indeed quicker, more efficient and less expensive than the judicial alternative. In the absence of public access to details concerning individual receiverships, which access the FHLBB and FSLIC have so far refused to grant,[685] one is forced to rely on the opinions in the agency itself.

Furthermore, even if it can be demonstrated that the *Hudspeth* process is more efficient and less expensive, this does not necessarily imply that it is as *fair* a process as that available in the courts. Without some substantial restructuring, along the lines suggested in this article,[686] it is hard to accept that this can be possible.

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[677] *See supra* notes 234-35 and accompanying text (citing cases in which the FSLIC attempted to avoid the effect of judgments already entered against thrifts).

[678] *See supra* text accompanying notes 734-39.

[679] *See supra* text accompanying note 630.

[680] *See infra* text accompanying note 766 (Recommendation 5).

[681] *See supra* note 536.

[682] *See supra* text accompanying notes 556, 587.

[683] *See supra* note 560.

[684] *See infra* text accompanying note 767 (Recommendation 6).

[685] *See infra* note 726.

As with any complex regulatory process designed to protect the public, there has to be some tradeoff between the demands of fairness and efficiency. This involves a fundamental policy judgment that in the present context, given the scale of thrift liquidations and the size, range and variety of creditor claims involved, is one of national import. It is a judgment that should be made by the originator of the deposit protection system itself, in other words, Congress. Hence the evaluation that follows in this article, and the recommendations for improvement to the existing arrangements, are based on the assumption that Congress actually would expressly decide to authorize an administrative claims adjudication process.

A. *Fairness and Flexibility.*

The *Hudspeth* procedures are partly intended to assist the receiver in maintaining a degree of flexibility when processing claims. Indeed, section 1729(d) seems clearly to envisage this goal where it refers to "settling, compromising, or releasing" claims. Hence the FHLBB is anxious to ensure that the FSLIC Receiver has an opportunity to accommodate disputed claims before the parties confront each other in litigation. In practice, many potentially complex claims are resolved at this level with a minimum of formality and expense.[687] The receiver also needs time to investigate the thrift's activities, many of which might have been concealed from the regulatory examiners before the thrift was seized. The thrift's records might well be in disarray.

The FSLIC Receiver is carefully distinguished, both linguistically and institutionally, from the FSLIC Corporate. Hence it is misleading to assume that the FSLIC as insurer of deposits (and therefore as the major creditor in any receivership) is identical to the FSLIC Receiver itself.[688] Nevertheless, the FSLIC Receiver still has the ordinary receivership responsibility of preserving the assets of the receivership for the optimal benefit of creditors. In practice the special representatives must surely interact with policy formulators at the FSLIC Corporate in deciding whether, as the best overall strategy, to participate in a purchase and assumption transaction[689] or to transfer insured accounts.[690] The potential size of creditor claims must inevitably weigh heavily in their decisions. It is hard to accept, therefore, that the severe financial strictures under which the FSLIC as a whole has been placed, as a result of the depletion of its insurance fund and the escalation in administrative and liquidation costs,[691] do not have a very strong influence when the FSLIC Receiver's Special Representatives make their decisions to accept or reject claims.

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[686] *See infra* text accompanying notes 687-719.

[687] Interview, *supra* note 275.

[688] *See supra* text accompanying notes 196-98.

[689] *See supra* text accompanying notes 189-95.

[690] *See supra* text accompanying note 193.

1. *"Receiver's Determinations."* It is just these forms of prior involvement with the disputed claims that render the FSLIC Receiver virtually incapable of impartiality when it comes to adjudicating claims that remain in dispute after efforts to "settle" or "compromise" those claims have failed. To be sure, the mere fact that the FSLIC will inevitably fulfill the role of both creditor and receiver, if the agency is looked at as a unit, is not enough on its own to disqualify the FSLIC's appointment.[692] But the question is one of *degree,* and the degree of conflict at the receivership level is, in the present financial crisis, unacceptably high.[693]

Indeed, the whole character of the *Hudspeth* rules themselves suggests that the receiver is conceived of as having a partisan role in the claims determination process. The fact that fee counsel perform services as and where needed by the Special Representatives,[694] the fact that they provide confidential advice concerning claims to these representatives,[695] and the fact that the Special Representative is expressly charged to take "cost savings" into account in the selection of the persons assigned to review creditor claims,[696] all suggest that at the receivership level the review of claims is likely to be partisan, often unsympathetic, and certainly not detached.

If genuine adjudication were to take place at the receivership level, the process could hardly be described as fair to creditors if they and the receiver had moved beyond an atmosphere of "settlement" and "compromise." This is recognized by the FHLBB, which has changed the description of the receiver's decisions from "final determinations" to "receivers' determinations."[697] The alternative terminology conveys more accurately what really happens in claims determinations, where the first real "adjudication" only takes place before the Adjudication Division itself.[698]

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[691] *See supra* text accompanying notes 76-88.

[692] *See, e.g.*, Womble v. Dixon, 585 F. Supp. 728, 733 (E.D. Va. 1983) (holding that the insufficiency of receivership funds to pay all claims did not constitute a sufficient conflict of interest to warrant removal of the FSLIC as receiver), *aff'd in part and vacated in part,* 752 F.2d 80 (4th Cir. 1984).

[693] *See supra* text accompanying notes 621, 629-32 (discussing the due process test).

[694] *See supra* text accompanying notes 248, 261.

[695] *See supra* text accompanying notes 270-71.

[696] *See supra* text accompanying note 261.

[697] *See supra* note 275.

It would be much more compatible with the concept of independent adjudication and internal separation of powers to treat claims decisions at the receivership level not as a species of "adjudication," but as what they were probably always assumed to be, namely, the mere *acceptance* or *rejection* of claims, the validity of which is to be determined by an objective third party. This would help to reduce the importance of the conflicts of interest, real and perceived, under which the receiver labors. It would also liberate the receiver from the futile duty of trying to maintain an impartial posture in the administration of the receivership. And it would permit the receiver to represent more unequivocally the interests of the receivership as a whole when called upon to engage in some form of mandatory alternative dispute resolution[699] or when opposing a creditor in a claims dispute before the Adjudication Division.

2. *Administrative Adjudications ("Reviews").* The first real "adjudication" of creditors' claims takes place at the level of the Adjudication Division.[700] This is also the first place at which significant institutional separation might be assumed to take place, though even here there is extensive prior and continuing involvement by staff of the Adjudication Division with the receivership team when a thrift is seized.[701] The staff are warned to avoid discussing any details that might bear directly upon individual claims,[702] but there is little in the *Hudspeth* procedures that can prevent internal communication between Adjudication Division staff and the adjudicator, ex parte contacts between the receiver's agents and the adjudicator, and pressure on the adjudicator from the Board itself, on the one hand, and from the Director, OFSLIC (from whom the adjudicator has received the delegated power to adjudicate), on the other.

Perhaps a de facto Chinese wall has been created within the Adjudication Division. For administrative appeals, at least,[703] the initial reversal rate of receiver determinations seems to suggest that this has occurred. At present half of those receivers' determinations that have been taken on appeal have been reversed.[704] The decisions of the Adjudication Division are now also accumulating and are becoming available in Westlaw and LEXIS databases.[705] This development should aid in providing consistent guidance to the various receiverships and in subjecting the claims decisions to public scrutiny. In itself, the publication of their decisions should help to promote objectivity on the part of the adjudicators.

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[698] Interview, *supra* note 275.

[699] *See infra* text accompanying notes 715-17.

[700] *See supra* text accompanying notes 278-97.

[701] *See supra* text accompanying notes 249-50.

[702] In particular, the attention of the Division's staff is drawn to Baltimore Contractors, Inc. v. United States, 643 F.2d 729 (Ct. Cl. 1981). In *Baltimore Contractors*, the court held that the continuing involvement by the Architect of the Capitol and his staff with the House board and its members created the appearance of unfairness and the possibility of improper influence in connection with the board's adjudication of a dispute between the architect and a contractor.

[703] Requests for expedited relief, *see supra* text accompanying notes 300-11, have been granted in only 3% of the cases (i.e. 8 out of 304 cases, as of March 23, 1988). Letter from June O. Stewart to Lawrence A. Baxter (Mar. 23, 1988). One of the reasons given for this extremely low success rate

Yet even if improper influences have not, as a matter of practice, been brought to bear, it would still be appropriate to institutionalize the adjudicators' independence by elevating the office to the status of an administrative law judge[706] in order to provide the security of tenure and insulation from external pressures that those officers enjoy.[707] This might require specific statutory authorization.[708]

The record presented to the adjudicator on appeal is also open to criticism. The receiver is required by the Adjudication Division to assume an adversarial role in the appellate proceedings,[709] but there is nothing to suggest that the privileged and confidential advice that she receives from fee counsel, for example, does not find its way into the office of the appellate adjudicator. If there is a possibility of this occurring, then there is a danger of unfairness to the creditor-claimant—who will not be fully apprised of the information upon which the adjudication will be based. Similarly, while internal staff memos might be acceptable

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is that creditors have only the cost of a postage stamp to lose in filing such requests; as a result a very high proportion of frivolous requests are filed. Interview, *supra* note 275.

[704] That is, 43 out of 85 cases, as of March 23, 1988. Letter from June O. Stewart, *supra* note 703.

[705] These databases were added in 1988.

[706] A model for this proposal is the West Virginia statute governing the regulation of failing financial institutions, which contains comprehensive provisions for the determination by receivers of the claims of creditors. W. VA. CODE § 31A-7-13 (1988). A person adversely affected by the complete or partial rejection of a claim is entitled to a formal hearing before an independent, qualified hearing examiner appointed by the commissioner. *Id.* §§ 31A-7-14, 31A-8-1. After this remedy has been exhausted, the claimant may seek judicial review. *Id.* § 31A-8-2.

[707] *See* 5 U.S.C. §§ 3105, 3344, 5372 (1982) (procedures for appointing ALJs).

[708] Although agencies are free to add to the procedural requirements of the APA, *see, e.g.*, Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 524 (1978), the Office of Personnel Management will only assign to the agency as many ALJs as "are necessary for proceedings required to be conducted in accordance with sections 556 and 557" of the APA. 5 U.S.C. § 3105. Since formal adjudication is not required by either the Home Owners' Loan Act or the National Housing Act, *see supra* text accompanying notes 489-97, it is likely that OPM would not approve the assignment of ALJs for *Hudspeth* purposes.

[709] *See supra* text accompanying notes 284-311.

where they emanate from the same level as the adjudicator,[710] they surely constitute an improper influence where they emanate from an adviser to a *party* to the proceedings. The rules should therefore be drafted so as to ensure that only material disclosed in the record should form the basis of the decision on appeal.

On the other hand, it should be recognized that large numbers of creditor appeals can be, and have already been, resolved without full, trial-type, oral hearings. The written record is often a sufficient basis upon which to resolve the dispute.[711] Hence it would seem unduly burdensome to insist on the invariable adoption of all the formal adjudication requirements provided for in the APA.[712] A hybrid procedure, which would permit the administrative law judge (or perhaps a preliminary adjudication officer of lesser status) to make an initial, reviewable decision whether to order that the appeal be conducted on the basis of an oral, evidentiary hearing, seems appropriate. Such a "shortened" or "modified" procedure has long been applied at the Interstate Commerce Commission, where it appears to have successfully eliminated unnecessary formality and expedited decisions involving simple disputes.[713] The Civil Aeronautics Board also successfully experimented with "expedited" procedures.[714]

Finally, on many occasions disputes between creditors and receivers might better be resolved through alternative dispute resolution techniques (ADR). A great variety of such techniques is available, ranging from arbitration, through mediation, to conciliation,[715] and many of these are already employed by federal agencies.[716] Their adoption is strongly advocated by the Administrative Conference as a means of expediting agency proceedings and reducing costs.[717] The receiver's powers under section 1729(d) are quite capable of accommodating ADR.

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[710] *Cf.* United Steelworkers v. Marshall, 647 F.2d 1189, 1210-16 (D.C. Cir.) (holding that there is no statutory basis in the APA for a separation-of-functions requirement in Occupational Safety and Health Administration rulemaking procedures, and that a staff advocate need not isolate herself from others within her agency), *cert. denied,* 453 U.S. 913 (1981).

[711] Interview, *supra* note 275.

[712] *See* 5 U.S.C. §§ 554-557 (1982).

[713] *See* Edles, *The ICC Hearing Process: A Cost-Benefit Approach to Administrative Agency Alternative Dispute Resolution,* 16 Transp. L.J. 99 (1987). Some consideration would have to be given to the criteria by which the preliminary decision is to be made. The "material issue of fact" criterion is not always easy to apply at the initial decision stage, but placing a threshold on appealable claims according to the amount at issue carries its own potential for arbitrariness.

[714] *See id.* at 103. Yet another illustration of the apparently successful use of multi-channel adjudicatory procedure is provided by recent developments at the Commodity Futures Trading Commission, where the agency employs three types of procedures for its reparations adjudications: voluntary, summary and formal. *See* Smythe, *The Reparations Program of the Commodity Futures Trading Commission: Reducing Formality in Agency Adjudications,* 2 Admin. L.J. 39, 56-60 (1988).

[715] *See, e.g.,* Harter, *Points on a Continuum: Dispute Resolution Procedures and the Administrative Process,* 1 Admin. L.J. 141, 144-45 (1987) (suggesting that full range of ADR techniques be used to address the needs of the legislative process).

[716] *See* Riggs & Dorminey, *Federal Agencies' Use of Alternative Means of Dispute Resolution,* 1 Admin. L.J. 125, 137 (1987).

As argued in the previous section,[718] however, the receiver really holds the posture of a committed party and for ADR to work where attempts to "settle, compromise, or release" claims have already failed, it would have to be imposed by a superior authority. The adjudicator in the Adjudication Division would be well-placed to choose between arbitration or mediation, for example.[719] The rules should be drafted so as to create the power to appoint an arbitrator, for example, and to order that the receiver and claimant engage in compulsory arbitration, if such is the most appropriate means of ADR.

B. *Efficiency and Cost.*

The main motivation for developing the *Hudspeth* procedures has been to save costs and expedite the determination of creditor claims.[720] Not only is this made possible by the informality of the claims processing procedure, in which the receiver is able to "settle, compromise, or release claims,"[721] but the adjudicatory procedure before the Adjudication Division of the Office of General Counsel at the FHLBB is also thought to be potentially quicker and less expensive than de novo judicial proceedings. Does the *Hudspeth* process fulfill this promise?

1. *The Receivership Level.* An embarrassment to the agencies' claim that FHLBB adjudication expedites claims determination is the progress of the *Hudspeth* case itself since the Fifth Circuit's decision. The court of appeals issued its final opinion on May 23, 1985, redirecting Hudspeth's claims "to the administrative track." Yet almost three years later Hudspeth had not been granted a *receiver's* determination of his claim.[722] It was only after approaching his local Congressman that Hudspeth's attorney received any formal response to Hudspeth's request for a

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[717] Administrative Conference of the U.S., Agencies' Use of Alternative Means of Dispute Resolution, Recommendation No. 86-3, 1 C.F.R. § 305.86-3 (1988). *See generally A Colloquium on Improving Dispute Resolution: Options for the Federal Government,* 1 ADMIN. L.J. 399 (1987) (sponsored by the Administrative Conference).

[718] *See supra* text accompanying notes 692-99.

[719] The Director of the Adjudication Division is hospitable to the idea of using ADR. Interview, *supra* note 275.

[720] *See supra* text accompanying note 92; *see also* Felt, *FSLIC Receivership Claims Procedure,* in ALI-ABA, FAILING FINANCIAL INSTITUTIONS 529, 531-34 (1987) (study materials).

[721] 12 U.S.C § 1729(d) (1982).

[722] *See supra* text accompanying notes 273-77 (discussing "receiver's determinations").

determination of his claim.[723] This came in the form of a proposed initial determination, dated December 24, 1987, denying his claims. Since Hudspeth's attorney has requested reconsideration, the matter has not even reached the Board, or "appellate," stage. Hudspeth's attorney estimates that the original proceedings in chancery court and any possible appeal "would surely have reached resolution long before 1988"![724]

If the *Hudspeth* case itself were to be taken as a guide to the speed and efficiency of the *Hudspeth* process, the agencies' arguments would not be cogent at all. On the other hand, the FHLBB was really only in a position freely to develop its procedures after its authority to do so was recognized in *Hudspeth*. Hence the case might merely be an unfortunate exception. Nevertheless, although statistical information is difficult to compile[725] and not necessarily even available,[726] there do seem to have been some considerable delays at the receivership level,[727] at least in the processing of contentious claims.[728] One probable source of this delay is the failure to subject receiver's agents, at some points in the process, to rigid time limits.[729] This should be remedied.[730]

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[723] Telephone interview, *supra* note 107. The details are now more fully documented in Hudspeth's amicus brief in the *Coit* case. *See* Brief Amicus Curiae of Joseph M. Hudspeth in Support of Petitioner, Coit Independence Joint Venture v. FSLIC, 108 S. Ct. 1105 (1987) (No. 87-996); *see supra* note 18.

[724] Brief Amicus Curiae of Joseph M. Hudspeth at 4 n.2. As this article went to press, the author was advised that the FSLIC had settled Hudspeth's claim. Telephone interview with Wylene W. Dunbar, counsel for Hudspeth (Aug. 18, 1988). It should also be noted that the claims in the *Morrison-Knudsen* group of cases have now been settled. Telephone interview, *supra* note 390.

[725] Statistics are not easy to compile, partly because the performance of claims processors varies from region to region, Telephone interview, *supra* note 202, and partly because aggregate statistics do not reflect what happens in individual cases.

[726] While I have experienced generous assistance from the Adjudication Division of the Office of General Counsel, FHLBB, it appears that there is in some quarters of the agency a predilection for secrecy. For example, an attempt by one attorney to use the Freedom of Information Act to compile statistics from information concerning the claims processed in specific receiverships was foiled because the FHLBB adopted the view that such information is not subject to disclosure under the FOIA, creditor claims being "against the receiver, not the FSLIC." Letter from Ella P. Allen to Sarah H. Comley (Apr. 8, 1988). The agencies' position in this regard sits somewhat awkwardly with the FSLIC's argument that, as receiver, it enjoys sovereign immunity. *See supra* note 148. Its legality is also debatable. *Cf.* Rocap v. Indiek, 539 F.2d 174, 175-76 (D.C. Cir. 1976) (Federal Home Loan Mortgage Corporation subject to disclosure requirements even though it is self-financing). The "governmental control" of the FSLIC, whether FSLIC Corporate or FSLIC Receiver, is surely even greater.

This refusal to disclose information concerning receiverships appears to be maintained even in the face of requests from congressional committees. *See* Staff of House Comm. on Banking, Finance & Urban Affairs, 100th Cong., 2d Sess., Federal Asset Disposition Association: Report of an Inquiry into its Operations and Performance ch. XI (Comm. Print 1988), *reprinted in* 134 Cong. Rec. H2228-30 (daily ed. Apr. 21, 1988).

[727] Some of the attorneys I interviewed complained of indordinate delays in receiving responses from receivers. *Cf.* Memorandum of Law of Third-Party Defendants at 33, FSLIC v. Greenbaum, No. L-070020-87 (N.J. Super. Ct. 1988). This memorandum of law asserts that delays in the administrative process "can be extraordinary." It then cites W-V Enters. v. FSLIC, 234 Kan. 354, 673 P.2d 1112 (1983), as a case in which the FSLIC commenced an interpleader action to enjoin enforcement of a judgment and attachment order against a thrift in receivership *two years* after the Kansas Supreme Court had affirmed the judgment against the FSLIC as receiver.

2. *The Board Level.* At the Board level it appears that the process is becoming more expeditious. As of March 23, 1988, the Adjudication Division had received 129 administrative appeals, 85 of which it had completed.[731] Almost half of these were completed in four weeks or less.[732] It might be reasonable to assume, therefore, that as a general rule the speed and informality of the *adjudicative* process, once fully implemented and staffed, would render the determination of claims less expensive and more efficient than it might be if the agencies had to rely on the courts. Agency staff insist that this is the case.[733]

3. *Previously Adjudicated Claims.* Considerations of efficiency and cost do not, however, justify the agencies' attempts to avoid the effects of judgments already entered against thrifts prior to their being placed in receivership.[734] The agencies' view that preexisting but unappealed or unexecuted judgments should be vacated is dictated by their belief that section 1464(d)(6)(C) necessarily strips the courts of jurisdiction.[735] As has been argued, however, this view of section 1464(d)(6)(C) is wrong.[736] In any event, the agencies' position raises very serious article III problems.[737]

Furthermore, the agencies' view could also place a potential litigant in a hopeless position. For example, in *Homestead Savings v. Life Sav-*

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[728] As to overall efficiency, the Southern Region, for example, has greatly improved the speed of its claims processing: in 1985, prior to the development of the *Hudspeth* procedures, the average length of time for processing a claim was 494.6 days; this time had dropped, in January 1988, to 18.1 days. Telephone interview with Judith L. Friedman, Associate General Counsel, FHLBB (May 6, 1988). Yet this information can tell us little about nonroutine, contentious claims.

[729] *Cf. supra* note 277.

[730] *See infra* text accompanying notes 764-65 (Recommendation 4); *cf.* Admin. Conference of the U.S., Time Limits on Agency Actions, *reprinted in* 1 C.F.R. § 305.78-3 (1988).

[731] Letter from June O. Stewart, *supra* note 703.

[732] *Id.*

[733] *See, e.g.*, Felt, *supra* note 720, at 533.

[734] *See supra* notes 118-20; *supra* text accompanying notes 234-35.

[735] Telephone interview, *supra* note 390. An incidental argument is that a creditor with an adjudicated claim should still be required to resubmit the claim for fresh determination by the receiver, because if the receiver were obliged to accept the claim as valid this might, at least psychologically, impede the settlement and negotiation process. Interview with David A. Felt, Assistant General Counsel, FHLBB, and Mark Gabrellian, Trial Attorney, FHLBB, in Washington, D.C. (Oct. 22, 1987).

[736] *See supra* text accompanying notes 394-403, 422-25.

[737] *See supra* text accompanying note 589-99.

ings & Loan Association[738] the plaintiff had been awarded a jury verdict against the defendant thrift of more than $6.2 million, which amount had already been paid over to the clerk of the court. But the plaintiff then found itself in a Catch-22 situation: because the verdict effectively pushed the defendant into insolvency, the defendant was placed into receivership by the FHLBB, and the FSLIC Receiver moved that the court vacate the judgment and relinquish jurisdiction. The motion was denied. As Judge Roszkowski observed:

> Accepting the FSLIC's argument [that the judgment should be vacated] would put plaintiffs like Homestead in an untenable position. With the defendant savings and loan in a shaky position, a verdict for the plaintiff would probably press the defendant into receivership. Of course, the plaintiff could not pursue its administrative remedy until it had actually forced the defendant into receivership. The plaintiff going to trial either would get a soon-to-be-invalid verdict, a receiver, and a de novo tour through administrative proceedings or the plaintiff would get a defendant's verdict that would likely remain valid and res judicata.[739]

Such circumstances create a potential temptation for the FHLBB to use receivership appointments as a means of denying litigants their just claims.

It is also difficult to understand why the receiver's ability to settle or negotiate the claim would be impeded by recognition of previous judgments. Once the thrift is placed in receivership, section 1464(d)(6)(C) effectively prevents the creditor from executing his judgment. He has no choice but to take into account the same strategic considerations as any other creditor with a valid claim. And the appellate process, even if incomplete, is unlikely to be more time-consuming or costly than readjudication of the claim by the receiver.

C. *Judicial Review.*

The jurisprudence relating to the nondelegation doctrine,[740] article III,[741] and possibly even due process,[742] dictates that there should be meaningful judicial review of the adjudicator's and the FHLBB's final decisions. In view of the ambiguity created by section 1464(d)(6)(C),[743] clear provision for judicial review should be made by Congress when clarifying the FHLBB's statutory powers.[744]

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[738] 668 F. Supp. 1121 (N.D. Ill. 1987) (opinion vacated and removed from bound volume, but appears in West's advance sheets). In terms of a settlement order, *see* No. 86 C 20268 (Dec. 2, 1987), the FSLIC, as receiver for Life Savings and Loan Association, agreed to acquiesce in the order of the court and forgo all post-trial motions and appeals on the condition that the plaintiff stipulate to the vacating of the judge's opinion. Consequently, West Publishing withdrew from its final volume the original opinion issued by the court. Telephone interview with Jeffrey H. Hornstein, counsel for Homestead (May 2, 1988).

[739] 668 F. Supp. at 1123.

[740] *See supra* text accompanying note 520-37.

[741] *See supra* text accompanying note 538-88.

[742] *See supra* text accompanying note 601-37.

The value of judicial review, even under the "arbitrary and capricious" standard,[745] will depend on the quality of the record before the court,[746] so the exhortations made earlier[747] are relevant in this context as well. It is suggested, however, that the "substantial evidence" standard of review is merited in the case of creditor claims. The reason is that the determination of the validity and amount of creditor claims is likely to involve "adjudicative facts," as opposed to "legislative facts,"[748] inasmuch as the specific details of thrift/creditor transactions will be in issue, rather than more general questions of thrift regulatory policy. Hence it seems appropriate that the reviewing court should be able to evaluate the adjudicator's decision according to the evidence presented in the adjudication record. If proper recordkeeping procedures are observed, there is no reason why the agency could not accommodate this standard of review.

As review will take place with the benefit of a full record, jurisdiction to review should, in accordance with the recommendation of the Administrative Conference, be placed in the courts of appeals.[749]

D. *Procedural Rules.*

With the creation of a restructured claims adjudicatory process there arises the need for the implementation of detailed procedural rules. These are best devised by the agency, using a notice and comment rulemaking process.[750] In the light of past experience,[751] the FHLBB should be particularly sensitive to the need for adequate public consultation and guidance on the administration of its adjudications.

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[743] *See supra* text accompanying notes 394-403.

[744] *See infra* text accompanying note 767 (Recommendation 6).

[745] *See supra* text accompanying notes 498-509.

[746] *See, e.g.*, Home Box Office, Inc. v. FCC, 567 F.2d 9, 54 (D.C. Cir.), *cert. denied*, 434 U.S. 829 (1977) (emphasizing the importance of a coherent record, even in informal rulemaking proceedings, to meaningful judicial review); *see also* 1 C.F.R. § 305.77-3 (1988).

[747] *See supra* text accompanying notes 709-10.

[748] *See* 2 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 12.3 (1979) (discussing the distinction between adjudicative and legislative facts).

[749] *See* Admin. Conference of the U.S., The Choice of Forum for Judicial Review of Administrative Action, *reprinted in* 1 C.F.R. § 305.75-3 (1988).

[750] Because they deal with "procedure" and not substance, there may be doubt whether such rules must be published in the Federal Register in accordance with § 553(d) of the APA. *See* 5 U.S.C. § 553(b)(A) (1982). Even if publication is not required by the APA, the FHLBB could justifiably be criticized if it failed to publish the rules when so many creditors are affected. Dealing with interpretive rules and statements of general policy, the Administrative Conference has recommended that agencies voluntarily publish any rules that are "likely to have substantial impact on the public." *See* Admin. Conference of the U.S., *reprinted in* 1 C.F.R. § 305.76-5 (1988). One commentator has already noted the relevance of this recommendation to the procedures adopted by the FHLBB. *See*

If Congress were to create a claims adjudication process, or if the Court were in *Coit* to declare that the authority to do so already exists, the FHLBB should expeditiously set about the task of devising appropriate rules that incorporate the structural suggestions as well as the time and jurisdictional limitations urged in the preceding sections of this article.[752] In addition, the rules would have to be considerably more complex than those contained in the Interim and Supplemental Rules.[753] As presently formulated, these make no provision for the consolidation of claims, joinder of third parties and counterclaims, or for meaningful discovery and subpoenas (to give a few examples). Given the complex nature of most of the disputes that have already arisen in the reported cases, it is hard to imagine how the FHLBB could adjudicate such claims efficiently without these devices. In any event, the requirements of procedural due process would seem to dictate the provision of at least some facilities whereby parties may adequately establish their claims and challenge adverse evidence.

CONCLUSIONS

In this article it has been argued that legislation upon which the FHLBB and the FSLIC rely for the *Hudspeth* scheme is very dubious, not only because of the vagueness and ambiguity of the statutory language concerned, but also because vague statutory authority is insufficient in the face of the numerous constitutional concerns that are raised by the *Hudspeth* scheme as it is presently constructed. I have also tried to show, however, that if Congress were to act unambiguously, it could establish an administrative claims adjudication scheme that would survive constitutional challenge. To achieve this objective, Congress and the FHLBB would have to institute a number of safeguards designed to provide the protections mandated by the Constitution. These safeguards are encapsulated in the following recommendations.

Pfeiler, *supra* note 54, at 461 n.102. In any event, to the extent that the rules might deal with such matters as the ranking of claims, *see supra* note 195, they would clearly have to be published in accordance with the APA's notice and comment procedures.

[751] During the preparation of this article as a report for the Administrative Conference, the author encountered numerous complaints regarding the availability of, and reluctance on the part of the FHLBB to finalize, the procedural rules governing the *Hudspeth* claims process. The FHLBB has proven responsive to these complaints: it has published interim rules and supplemental proposed rules, and has virtually finalized its present procedures. *See supra* text accompanying notes 200-05.

[752] The rules presently devised by the FHLBB fail to address any of the concerns expressed in the recommendations presented in this article.

[753] *See supra* text accompanying notes 253-69.

A. *Recommendations.*

1. *Acquisition of Statutory Authority for Claims Adjudication.* While the FHLBB might have statutory authority under section 1464(d)(11) to create a claims adjudication system,[754] if such is the intention of Congress, it should be stated in express terms. This is necessary for two reasons. First, notwithstanding the deference ordinarily shown by courts to the construction by agencies of their statutory mandates,[755] vague statutory powers are interpreted restrictively where they infringe on constitutional rights.[756] Secondly, in accepting deviations from the article III adjudicative model, the Supreme Court has relied partly on the fact that Congress has expressed a clearly stated legislative purpose to depart from the model.[757] This reliance seems particularly apposite in the present context since, unlike the situation with receivership powers, Congress, when it has directly addressed the issue of administrative adjudication, has always prescribed fairly detailed procedural rules.[758]

To clarify the situation, the FHLBB should seek direct authority for an administrative claims adjudication process. While Congress need not go so far as to specify the detailed procedures, Congress should make a basic policy decision as to whether an administrative adjudication process is preferable to the regular judicial process. If Congress does reach such a conclusion, it should act to create adjudicative authority and an adjudicative process, clearly and unambiguously, and along the following lines.

2. *Formalization of the Adjudicative Process.* In order to meet due process and article III concerns of impartiality and fairness,[759] Congress should establish a bifurcated process for adjudicating claims. Where hearings are required to resolve matters in dispute, administrative law judges should adjudicate. The necessary authority to engage administrative law judges should be granted by Congress.[760] Where claims can be resolved on the basis of written documentation alone, the FHLBB should be permitted to use simplified, less formal procedures, independent of the receiver but not necessarily involving administrative law judges.[761]

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[754] *See supra* text accompanying notes 427-29.

[755] *See supra* text accompanying notes 325-36.

[756] *See supra* text accompanying notes 129-31.

[757] *See supra* text accompanying notes 596-98.

[758] *See supra* text accompanying notes 393, 401-03.

[759] *See supra* text accompanying notes 671-75.

[760] *See supra* text accompanying note 708.

[761] *See supra* text accompanying notes 711-14.

The statutory scheme should make it clear that receivers do not "adjudicate" claims, and the rules should treat receivers as parties who are on equal terms with claimants.[762]

3. *Procedures for Alternative Dispute Resolution.* In order to avoid unnecessary formality and delay, administrative law judges should be empowered to order that parties (including receivers) engage in Alternative Dispute Resolution where this is appropriate.[763]

4. *Procedural Rules.* Once the claims adjudications process has been authorized, the FHLBB should engage in a notice-and-comment rulemaking procedure, setting forth comprehensive and adequate rules of practice for claims adjudication.[764]

A probable source of delay in receivership determinations is the failure to subject receivers to fixed time limitations.[765] The FHLBB's final rules should provide for strict, albeit reasonable, time limits that are applicable not only to claimants but also to receivers and their agents.

5. *Jurisdiction over Claims Already Adjudicated in Court.* In order to avoid agency aggrandizement at the expense of article III courts, and in order to prevent the temptation to use receivership decisions as a strategic device to the detriment of the creditors of thrifts, the FHLBB and the FSLIC Receiver should not be permitted to override judgments already given by federal and state courts, whether or not these remain appealable.[766] The agencies' power to determine claims should not encompass judgments in favor of creditors if such judgments have already been entered by a court of competent jurisdiction before thrifts have been placed in receivership. The FSLIC Receiver should either acquiesce in these judgments or pursue its ordinary post-trial remedies.

6. *Judicial Review.* Congress should make adequate provision for judicial review of claims decisions by the FHLBB.[767] To this end, Congress should specify that the courts of appeals have review jurisdiction and that the "substantial evidence" standard should apply.

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[762] *See supra* text accompanying notes 692-99.

[763] *See supra* text accompanying notes 715-19.

[764] *See supra* text accompanying notes 750-53.

[765] *See supra* text accompanying notes 722-30.

[766] *See supra* text accompanying notes 734-39.

[767] *See supra* text accompanying notes 740-49.

B. *General Observations.*

It is important to conclude with a reminder of the limited scope of this article. The resolution of creditors claims in receiverships takes place within a much broader context that is itself controversial, or potentially so. No attempt has been made here, for example, to examine the underlying causes of thrift failure and whether the problems that have led to the adoption of the *Hudspeth* doctrine might be obviated altogether by a different system of thrift regulation.[768]

Also beyond the scope of this article is the question of the discretionary power exercised by the FHLBB and the FSLIC in determining whether to place a thrift in receivership and, once this has been done, whether to liquidate its assets or transfer the assets and liabilities to another thrift. As was noted earlier, the FHLBB and the FSLIC exercise an enormous amount of discretion, both when the FHLBB decides to appoint a receiver and when the FSLIC Receiver decides whether to engage in some form of purchase and assumption transaction or to liquidate the assets of the receivership. These agency decisions have a major impact on the rights of creditors. In the case of a partial purchase and assumption transaction, for example, a creditor might quite arbitrarily be omitted from the benefits of the transfer of assets and liabilities.[769] These decisions are, of course, heavily laden with questions of policy, and so they are not easily susceptible to codification.[770] Nevertheless, their significance strongly suggests that thought should be given to the means by which creditors might be protected,[771] whether in the courts[772] or perhaps through the use of guidelines.[773]

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[768] For a discussion of suggested reform in bank regulation, see J. Macey & G. Miller, Bank Failures, Risk Monitoring, and the Market for Bank Control (1988) (draft report to the ACUS); *see also supra* note 24.

[769] *See supra* text accompanying notes 194-95. In addition to affecting the procedural rights of creditors and their prospects of fully recovering their claims, the decision to subject creditors to the *Hudspeth* procedures may have a direct impact on the substantive rights themselves. For example, the rights of parties to loan agreements may be significantly affected if these rights are determined by *Hudspeth* adjudicators. *See* Pfeiler, *supra* note 54, at 448-57.

[770] *Cf.* Getty v. FSLIC, 805 F.2d 1050, 1054 (D.C. Cir. 1986). Considering pre-receivership action by the FSLIC, the *Getty* court said, "Congress recognized that in authorizing acquisition of distressed institutions FSLIC would need absolute discretion in some areas, e.g., determining who is qualified to bid . . . and calculating the cost of the bids." *Id.*

[771] Some attention has been given to protecting the rights of the officers of thrifts. *See, e.g.*, Malloy, *Adjudication Practices and Procedures of the Federal Bank Regulatory Agencies,* in 2 ADMINISTRATIVE CONFERENCE OF THE UNITED STATES: RECOMMENDATIONS AND REPORTS 1215, 1332-34 (1987) (recommending greater publicity of adjudications to help guide the officers of thrifts); *Student Project: Savings and Loan Insolvency in the '80's,* 15 AKRON L. REV. 441 (1982). The position of creditors has, however, been ignored.

[772] *Cf. Getty,* 805 F.2d at 1057-62 (applying an "arbitrary and capricious" standard in setting aside award to competing bidder); Hartigan v. FHLBB, 746 F.2d 1300, 1310 (7th Cir. 1984) (reviewing FSLIC's calculation of cost of bids to ensure consistent application of economic methodology).

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[773] The FDIC, for example, has published guidelines indicating when it will provide financial assistance to a failing bank. *See* Statement of Policy and Criteria on Assistance to Operating Insured Banks, 51 Fed. Reg. 44,122 (1986). As this article went to press the FHLBB published some guidelines with a similar purpose. *See supra* note 151.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-9

PRESIDENTIAL MANAGEMENT OF AGENCY RULEMAKING

by

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This report examines legal and policy issues surrounding presidential management of agency rulemaking. Its premise is that there has been sufficient experience with this activity to justify a general appraisal. Therefore, I examine the record of the Reagan administration's program, which is easily the most ambitious to date. Prominent controversies under that program are summarized here. The effort is not to provide a definitive administrative history, but to identify issues likely to arise in the future. My general conclusion is that a presidential oversight program has its place in the administrative state, but that certain controls on its exercise need to be adopted to keep it within appropriate bounds of law and policy.

I begin by outlining the constitutional framework within which oversight operates. Part II examines the comparative abilities of President and Congress to manage regulation, and concludes that there is a need for a limited executive role. I then described the evolution of presidential management programs from the early 1970's to date. Part IV assesses the comparative competence of the Office of Management and Budget and the agencies with regard to regulatory issues, and the relative power of these institutions. In Part V, I examine a number of controversies over the current program's fidelity to statutory authority. Part VI addresses the openness of executive oversight, and makes recommendations on an appropriate degree of disclosure. Finally, I seek criteria for identifying rulemaking functions that should be excepted from oversight.

I. The Constitutionality of Executive Oversight.

The Constitution does not foreshadow the rise of the modern "administrative state" that regulates so many aspects of our lives. Instead, the federal bureaucracy is almost wholly statutory in origin and organization, and therefore occupies an uneasy constitutional status.[1] The provisions of the original Constitution that delineate the interrelations of the three great branches of government are skeletal -- even cryptic -- in nature.[2] Perhaps because of the flexibility engendered by this characteristic, they have survived almost unchanged, despite the vast changes that two centuries have wrought in the nation.[3] Obviously, an accommodation of present practice to ancient text has been requisite. It exists in the form of a considerable body of constitutional doctrine and administrative law that provides legitimacy for modern institutions and guidance about their operations.[4]

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[1] See generally Symposium, The Uneasy Constitutional Status of the Administrative Agencies, 36 Am. U.L. Rev. 277 (1987).

[2] See Strauss, The Place of Agencies in Government: Separation of Powers and the Fourth Branch, 84 Colum. L. Rev. 573, 597-601 (1984).

Questions about the President's power to supervise administration in competition with Congress have always invited arguments of Hamiltonian sweep or Jeffersonian caution.[5] A

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[3] Four amendments have affected presidential elections, succession, and disability. U.S. Const. amend. XII (affecting procedures governing presidential elections); amend. XX §3 (providing succession procedures for President); amend. XXII, §1 (establishing maximum period one can hold presidential office); amend. XXV, §3 (establishing procedures for presidential disability). The seventeenth amendment provided for the direct election of senators.

[4] *See* Elliot, INS v. Chadha, *The Administrative Constitution, the Constitution, and the Legislative Veto*, 1983 Sup. Ct. Rev. 125, 166-70; Bruff, *Presidential Power and Administrative Rulemaking*, 88 Yale L.J. 451 (1979).

[5] Classic arguments of this kind arose in 1793, concerning Washington's proposed Neutrality Proclamation. *See* J. Roche & L. Levy, The Presidency 10-12 (1964). Hamilton argued that the Proclamation was authorized by a grant of power in Article II:

> The second article of the constitution of the United States, section first, establishes this general proposition, "the EXECUTIVE POWER shall be vested in a president of the United States of America."
>
> The same article, in a succeeding section, proceeds to delineate particular cases of executive power... It would not consist with the rules of sound construction, to consider this enumeration of particular authorities, as derogating from the more comprehensive grant in the general clause, further than as it may be coupled with express restrictions or limitations.... The difficulty of a complete enumeration of all the cases of executive authority, would naturally dictate the use of general terms, and would render it improbable, that a specification of certain particulars was designed as a substitute for those terms, when antecedently used.... The

(Continued on next page)

brief review of the pertinent text and the major interpretive positions will outline this unresolved debate. Article II vests the "executive Power" in the President. At the least, this provision signifies the framers' rejection of proposals for a plural, divided executive.[6] Perhaps it means no more than that, but presidential partisans have always read it as a substantive grant of "executive" power, whatever that is.[7] Similarly, the President's duty to "take Care that the Laws be faithfully executed" may mean only that he must enforce particular statutory powers that Congress gives him,[8] or

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5 enumeration ought therefore to be considered, as intended merely to specify the principal articles implied in the definition of executive power; leaving the rest to flow from the general grant of that power....

James Madison responded with the Jeffersonian position:

> The natural province of the executive magistrate is to execute laws, as that of the legislature is to make laws. All his acts, therefore, properly executive, must pre- suppose the existence of the laws to be executed. A treaty is not an execution of the laws; it does not pre-suppose the existence of laws.... To say then that the power of making treaties which are confessedly laws, belongs naturally to the department which is to execute laws, is to say, that the executive department naturally includes a legislative power. In theory this is an absurdity...in practice a tyranny....
>
> Another important inference to be noted is, that the powers of making war and treaty being substantially of a legislative, not an executive nature, the rule of interpreting exceptions strictly, must narrow instead of enlarging executive pretensions on those subjects....

[6] See Strauss, supra note I-2, at 599-601.

[7] For a more modern statement of the Hamiltonian position, see Myers v. United States, 272 U.S. 52, 118 (1926).

[8] Id. at 177 (Holmes, J., dissenting): "The duty of the President to see that the law be executed is a duty that does not go beyond the laws or require him to achieve more than Congress sees fit to leave within his power."

that he derives a broader power to reconcile the body of legislation as a whole.[9] Finally, the President has explicit power to require the "Opinions in writing" of department heads regarding their duties. This clause, obscure of intent, grants the President at least some power to consult with his bureaucratic chiefs.[10] Its presence in the Constitution, however, suggests that the framers held a view of the presidency that is difficult to reconcile with expansive views of the office.[11]

Congress can respond to claims of broad presidential power by citing its Article I powers to legislate and its related authorization in the "necessary and proper" clause to pass laws effectuating powers vested in the other branches.[12] Today, it is generally accepted that the President is not free to contravene congressional policies embodied in statutes, at least in domestic contexts such as regulation.[13] This principle of congressional supremacy in ordinary legislation does not, however, tell us how to resolve disputes over power in the interstices between clear statutory commands.

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[9] Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 702 (1952) (Vinson, J., dissenting): "Unlike an administrative commission confined to the enforcement of the statute under which it was created, or the head of a department when administering a particular statute, the President is a constitutional officer charged with taking care that a 'mass of legislation' be executed."

[10] See Strauss, supra note I-2, at 646-48.

[11] Myers, 272 U.S. at 207 (McReynolds, J., dissenting):

> "It is beyond the ordinary imagination to picture 40 or 50 capable men, presided over by George Washington, vainly discussing, in the heat of a Philadelphia summer, whether express authority to require opinions in writing should be delegated to a President in whom they had already vested the illimitable power here claimed...."

[12] See generally Van Alstyne, The Role of Congress in Determining Incidental Powers of the President and of the Federal Courts: A Comment on the Horizontal Effect of "The Sweeping Clause", 36 Ohio St. L.J. 788 (1975).

[13] The Supreme Court early held that executive officers must obey statutory directives. Kendall v. United States ex rel. Stokes, 37 U.S. (12 Pet.) 524 (1838). That proposition is no longer in doubt, absent a challenge by the executive to the constitutionality of the statute. Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 588 (1952) (holding that President's seizure of steel mills was illegal because forbidden by statute).

Here, Presidents use executive orders to implement their directives to the bureaucracy, relying on any combination of constitutional and statutory authority that is thought to be available.[14] Thus, these orders often dwell in a zone of twilight, where authority is neither clearly present nor absent.[15] Although interstitial, the programs involved may prove suprisingly durable. Two prominent examples are orders promoting civil rights in government-related activities and orders seeking economic stabilization.[16]

The principle of congressional supremacy also does not tell us how to approach statutes that directly address the power of the constitutional branches. For these separation of powers controversies, the courts employ varying analytic approaches. There are two main competitors, with contrasting implications for the outcome. The Court has often used a formalistic approach that reasons logically from the constitutional text and the framers' acknowledged purpose to create three independent branches with distinct functions. These cases tend to draw bright lines between the responsibilities of the branches. In recent years, three landmark formalist decisions have produced victories for the executive. In *Buckley v. Valeo*,[17] In *INS v. Chadha*,[18] the Court invalidated the

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[14] *See generally* Levinson, *Presidential Self-Regulation Through Rulemaking: Comparative Comments on Structuring the Chief Executive's Constitutional Powers*, 9 Vand. J. Transnat'l L. 695, 710-12 (1976); Kennan, *Executive Orders: A Brief History of Their Use and the President's Power to Issue Them*, in Sen. Special Comm. on Nat'l Emergencies and Delegated Emergency Powers, 93rd Cong., 2d Sess., Executive Orders in Times of War and National Emergency 20 (Comm. Print 1974); Neighbors, *Presidential Legislation by Executive Order*, 37 U. Colo. L. Rev. 105

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[15] *See Generally* Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579, 634 (1952) (Jackson, J., concurring).

[16] *See* Fleishman & Aufses, *Law and Orders: The Problem of Presidential Legislation*, 40 Law & Contemp. Probs. 1

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[17] 424 U.S. 1 (1976). the Court refused to allow Congress to appoint executive officers.

[18] 426 U.S. 919 (1983).

legislative veto, by which Congress had sought to override executive action by means less formal than legislation. And in *Bowsher v. Synar*,[19]

The competing approach is a functional one that assesses the needs of each branch for protection of its "core" constitutional functions. These cases stress the framers' inclusion of checks and balances, shared powers that aid the overall strategy of controlling each branch and ultimately the government as a whole. Examples include *United States v. Nixon*,[20] recognizing a limited executive privilege, and *Nixon v. GSA*,[21] upholding congressional authority to regulate presidential papers. Functional analysis favors complex arrangements blending the powers of the branches; formalism tends to condemn them.

The Supreme Court has explained that formalism is appropriate for cases presenting a threat that one branch will aggrandize itself at the expense of another.[22] There, "good fences make good neighbors." Where the Court perceives no sign of aggrandizement, it employs the looser, functional approach. Thus, in *Morrison v. Olson*,[23] the Court upheld provisions of the Ethics in Government Act that provide for court-appointed independent counsels to investigate and prosecute high executive branch officials who are accused of serious federal crimes.

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[14] (1965). For a compilation of many important executive orders, *See* Office of the Federal Register, Presidential Proclamations and Executive Orders, January 20, 1961 -- January 20, 1985 (1985).

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[16] (1976); AFL-CIO v. Kahn, 618 F.2d 784 (D.C. Cir.) (en banc), *cert*. *denied*, 443 U.S. 915 (1979).

[19] 106 S.Ct. 3181 (1986); *see* Symposium, Bowsher v. Synar, 72 Cornell L.Rev. 421 (1987); Miller, *Independent Agencies*, 1986 Sup. Ct. Rev. 41 (1987); Verkuil, *The Status of Independent Agencies After* Bowsher v. Synar, 1986 Duke L.J. 779., the Court forbade an officer removable by Congress to perform executive functions.

[20] 418 U.S. 683 (1974).

[21] 433 U.S. 425 (1977).

[22] CFTC v. Schor, 106 S.Ct. 3245, 3261 (1986).

[23] 56 USLW 4835 (June 29, 1988).

The *Morrison* Court upheld a statutory provision allowing removal of independent counsel for "good cause," rejecting arguments that everyone performing executive functions, or at least all prosecutors, must be removable at the will of the President to protect his responsibilities under Article II. The Court then worked an explicit change in the law that will spark widespread argument and speculation about *Morrison*'s significance. *Buckley*, *Chadha*, and *Bowsher* had left many observers questioning the continued vitality of *Humphrey's Executor v. United States*.[24] That case upheld a "good cause" provision restricting the removal of Federal Trade Commissioners and, in dicta, gave independent agencies such as the FTC broad immunity from presidential supervision. *Humphrey's Executor* said, however, that the President could remove "purely executive" officers (whoever they are) at will.[25]

This portion of the opinion squelched recent Justice Department arguments that independent agencies cannot constitutionally operate free of plenary presidential removal power. Still, the Court called for an ad hoc inquiry into the relationship between a particular function and presidential supervisory needs. Moreover, the Court stressed that the independent counsel is not a policymaker in the broad sense, in contrast to agencies like the FTC and the Federal Reserve Board. Some independent functions may fall prey to the new balancing test.

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[24] 295 U.S. 602 (1935). Unlike *Bowsher*, this case raises no question of the aggrandizement of congressional power at the expense of a coordinate branch. Instead, the separation of powers question presented in this case is whether Congress impermissibly undermined, without appreciable expansion of its own powers, the role of the judicial branch.

[25] In *Myers v. United States*, 272 U.S. 52 (1926), the Court held that Congress could not condition presidential removal of an officer on the Senate's advice and consent. The Court would not allow Congress to expand the Senate's role beyond its explicit authorization to review appointments. The Court's formalist rationale was that no branch should have implied powers to participate in functions constitutionally assigned to another; because removal was an executive function, the Senate could not share it. The Court concluded that article II granted the President an illimitable power to remove those executive officials whom he had appointed. *Humphrey's Executor* limited the application of *Myers* to "purely executive" officers. *Morrison* replaced this test with an inquiry "whether the removal restrictions...impede the President's ability to perform his constitutional duty." This would depend, the Court said, on the nature of the restrictions and of the official's functions.

It would be a mistake, however, to read Morrison as a case that settles much beyond its context. The Court's formalist opinions, drawing bright lines between the branches, promote political accountability by clarifying the responsibility of executive officers for the choices they make in administering statutes.[26] When accountability cannot be expected to produce sound decisions, as in the situations covered by the Ethics in Government Act, it should be permissible to qualify executive authority.[27] Thus, Morrison appropriately endorsed congressional power to remedy special problems in prosecuting senior executives. It is not a broad warrant for shearing the President of control over other executive functions.

Although uncertainty still surrounds the constitutional status of the agencies and their amenability to presidential supervision, some generalizations can be ventured. Under the "Opinions" clause a President may require executive officers toreport their views on any policy issues that the President deems important. In return, the President may communicate his own policy views, or those of his chosen subordinates, to agencies, and may expect these views to be honored within the limits of discretion conferred by statute. In case of disagreement, however, the President may not simply render a decision himself when Congress has vested it in another officer.[28] Instead, the President's remedy is to remove the officer, within statutory limits on that power, in hopes of finding a more compatible replacement.[29]

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[26] See Bruff, On the Constitutional Status of the Administrative Agencies, 36 Am. U. L. Rev. 491 (1987); Sierra Club v. Costle, 657 F.2d 298, 405 (D.C. Cir. 1981): The court recognizes the basic need of the President and his White House staff to monitor the consistency of executive agency regulations with Administration policy. He and his White House advisers surely must be briefed fully and frequently about rules in the making, and their contributions to policymaking considered. The executive power under our Constitution, after all, is not shared -- it rests exclusively with the President. The idea of a "plural executive," or a President with a council of state, was considered and rejected by the Constitutional Convention. Instead the Founders chose to risk the potential for tyranny inherent in placing power in one person, in order to gain the advantages of accountability fixed on a single source. To ensure the President's control and supervision over the Executive Branch, the Constitution -- and its judicial gloss -- vests him with the powers of appointment and removal, the power to demand written opinions from executive officers, and the right to invoke executive privilege to protect consultative privacy.

[27] See Bruff, Independent Counsel and the Constitution, 24 Willamette L. Rev. 539 (1988).

These principles reveal an enduring tension between presidential supervision of execution and congressional supremacy over legislation.[30] They provide only a framework

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[28] The President and Accounting Officers, 1 Op. A.G. 624 (1823).

[29] The Jewels of the Princess of Orange, 2 Op. A.G. 482 (1831).

[30] In Myers, 272 U.S. at 135, Chief Justice Taft captured these tensions in a single pregnant passage:

> The ordinary duties of officers prescribed by statute come under the general administrative control of the President by virtue of the general grant to him of the executive power, and he may properly supervise and guide their construction of the statutes under which they act in order to secure that unitary and uniform execution of laws which Article II of the Constitution evidently contemplated in vesting general executive power in the President alone. Laws are often passed with specific provision for adoption of regulations by a department or bureau head to make the law workable and effective. The ability and judgment manifested by the official thus empowered, as well as his energy and stimulation of his subordinates, are subjects which the President must consider and supervise in his administrative control. Finding such officers to be negligent and inefficient, the President should have the power to remove them. Of course there may be duties so peculiarly and specifically committed to the discretion of a particular officer as to raise a question whether the President may overrule or revise the officer's interpretation of his statutory duty in a particular instance. Then there may be duties of a quasi judicial character imposed on executive officers and members of executive tribunals whose decisions after hearing affect interests of individuals, the discharge of which the President

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for addressing, and not a formula for answering, the hard questions that attend the actual administration of government. For example, what if presidential oversight is faithful to the letter of statutes, but appears to violate their spirit? On the other hand, should restrictions on removal of officers be read to forbid kinds of oversight that otherwise would be permissible? I address these and other issues below. In doing so, I begin with the premise that each of the two branches has a serious claim to the oversight of administration, and that accommodation should be sought wherever possible.[31]

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[30] cannot in a particular case properly influence or control. But even in such a case he may consider the decision after its rendition as a reason for removing the officer, on the ground that the discretion regularly entrusted to that officer by statute has not been on the whole intelligently or wisely exercised. Otherwise he does not discharge his own constitutional duty of seeing that the laws be faithfully executed....

[31] There is much wisdom in Professor Freund's observation that "[i]n the eighteenth-century Newtonian universe that is the Constitution, an excessive force in one direction is apt to produce a corresponding counterforce." Freund, Foreword: On Presidential Privilege, 88 Harv. L. Rev. 13, 20 (1974).

II. The Need for Executive Management of Rulemaking

Any appraisal of regulatory oversight must address two broad questions at the outset. First, what goals should oversight try to achieve? Second, which branches of government are suited to pursue each goal? Answering these questions separately helps to clarify issues of technique. For example, we should not belabor a branch for failing to achieve something that is beyond the present capacities of government generally.

The broadest possible role for oversight is "macromanagement," coordinating national policy on the grand scale. That is a highly complex task, and a central responsibility of government. Nevertheless, there are limits to the amount of coordination that any government can perform. The information necessary to make coherent centralized decisions about society as a whole simply does not exist, as the Soviets so consistently demonstrate.[1] Instead, we must seek "second best" levels of coordination that are geared to actually available knowledge.

A more limited goal is "micromanagement," which addresses regulation on a case-by-case basis. This kind of oversight can strive to conform individual rules to a set of general principles, such as efficiency or distributional equity. More modestly, it can remain within the compass set by the regulator, and ask only such questions as whether the rationale for the rule is internally consistent and whether factual support is present.

A vigorous call for macromanagement of rulemaking was made by the American Bar Association's Commission on Law and the Economy, to improve policy coordination and to avoid unnecessary cost, duplication, and conflict:[2]

> Our government has adopted a wide variety of national goals. Many of these goals -- checking inflation, spurring economic growth, reducing unemployment, protecting our national security, assuring equal opportunity, increasing social security, cleaning up the environment, improving energy sufficiency -- conflict with one another, and all of them compete for the same resources. One of the central tasks of modern democratic government is to make wise balancing choices among courses of action that pursue one or more of these conflicting and competing objectives.
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> While Congress establishes the goals, it cannot legislate the details of every action taken in pursuit of each goal, or make the balancing choices that each such decision requires. It has therefore delegated this task to the regulatory agencies. But we have given each of the regulatory agencies one set of primary goals, with only limited responsibility for balancing a proposed action in pursuit of its own goals against adverse impacts on the

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[1] *See*, e.g., T. Sowell, Knowledge and Decisions (1980).

[2] Federal Regulation: Roads to Reform 68 (1979).

pursuit of other goals. For most of these agencies, no effective mechanisms exist for coordinating the decisions of one agency with those of other agencies, or conforming them to the balancing judgments of elected generalists, such as the President and Congress. Appointed rather than elected, specialist rather than generalist, regulatory agency officials enjoy an independence from the political process - - and from one another -- that weakens the national ability to make balancing choices, or to hold anyone politically accountable when choices are made badly or not at all.

To illustrate the problem, the Commission noted that, as of 1979, at least 16 federal agencies bore regulatory responsibilities that directly affected the price and supply of energy. This diffusion of policymaking authority had persisted despite the earlier consolidation of several energy-oriented agencies into a Department of Energy. Similar multiplicity problems presented themselves with respect to antitrust, equal employment, industrial safety, and natural resources policymaking.[3] From this, the Commission concluded:

> Congress cannot perform these [balancing] tasks by legislating the details of one regulation after another; that is why Congress delegated rulemaking power to the agencies in the first place, and gave them a wide degree of discretion as to the content of the rules to be issued. The President is the elected official most capable of making the needed balancing decisions as critical issues arise, while the most appropriate and effective role for Congress is to review and, where necessary, to curb unwise presidential intervention.

The Commission did not clearly separate the question of the extent of feasible policy coordination by our government from the question of comparative institutional capacities to perform it. Perhaps for that reason, there is a considerable gap between the broad scope of the macromanagement problem the Commission perceived and its recommendations, which tended toward micromanagement.[4]

Most questions of macromanagement of regulatory policy can be settled only by Congress, through legislation, and even then quite imperfectly.[5] For example, such tasks as the

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[3] Id. at 73.

[4] The Commission recommended interagency review of regulatory analyses prepared by rulemakers, and, in more controversially passage of a statute authorizing the President to direct agencies to decide a limited number

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[5] See generally, Regulatory Organization, 5 Study on Federal Regulation, Sen. Comm. on Government Affairs,

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consolidation of scattered functions into the Department of Energy require legislation, but do not eliminate problems of coordinating policy.[6] The executive can play a role, however, analogous to that for the budget-- one of gathering and organizing proposals for congressional consideration. In contrast, most questions of micromanagement are better suited to the executive branch, which has the more direct power to order or influence particular regulatory actions. Still, congressional oversight can play a role here, in probing regulatory decisions and seeking information for statutory overhaul.

For several reasons, oversight by both branches tends to favor micromanagement. First, there is the intimidating prospect of assembling the information necessary to any serious effort at large-scale coordination. Second, legislative change is time-consuming and difficult--as the framers intended it to be. And third, the imperatives of electoral politics tend to force both branches to focus on short run solutions to problems. Thus, it seems both easier and more profitable to leave cosmic issues and statutory revision for another day, and to concentrate on pending regulations.

Congress is not well suited to coordinate policy, whether the goal be macromanagement or the application of consistent principles to particular contexts. The reasons for this lie in its decentralization, which stems partly from its institutional nature and partly from its current organization. Congress is a

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[4] of "critical" regulatory issues, and to order changes in their decisions. Roads to Reform, Ch. 5. See also Cutler & Johnson, Regulation and the Political Process, 84 Yale L.J. 1395 (1975).

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[5] 95th Cong., 1st Sess. 6-7, 67-81 (1977), for a defense of congressional prerogative and performance, in sharp contrast to the ABA Commission's views.

[6] Congress has often authorized the President to prepare government reorganization plans, which, within certain limits, may transfer, consolidate, or abolish agency functions. 5 U.S.C. § 901 et seq. The current statute forbids abolishing or transferring all the functions of an executive department or independent regulatory agency. Congressional desire to keep a close control on reorganization authority recognizes that the placement of a function in one agency rather than another can have important effects on substantive policy. See generally Karl, Executive Reorganization and Presidential Power, 1977 Sup. Ct. Rev. 1 For many years, Congress subjected presidential reorganization plans to legislative veto. In 1984, Congress amended the statute to require the plans to be approved by joint resolution. 5 U.S.C. §§ 908-12.

collectivity of 535 separately elected individuals. The self-interest created by its fragmented political bases sets distinct limits on the amount of centralization the institution will tolerate.[7] Congress is naturally nonheirarchical; its characteristic process is one of bargaining.[8] Although little will be accomplished without some delegations of authority to make the decisions on which the fate of legislation rests, concentrated power threatens the members' capacity to serve their own constituents, and tends to be resisted.

The centrifugal and centripetal forces within Congress are in constant tension and evolution.[9] In recent years, both houses of Congress have markedly decentralized.[10] A central goal, the opening of policymaking to more diverse influences, has been achieved, but at substantial cost to both the capacity to legislate and the consistency of oversight. The story is one of overreaction to perceived abuses. By the early 1970's, power in Congress was widely perceived to be overly centralized.[11] A series of reforms that took effect by the 1970's produced today's congressional structure.[12] In the

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[7] See Fiorina, Congressional Control of the Bureaucracy: A Mismatch of Incentives and Capabilities, in Congress Reconsidered 332-46 (L. Dodd & B. Oppenheimer, eds. 1981).

[8] Davidson, The Congressional Budget: How Much Change? How Much Reform?, in Congressional Budgeting 158 (W. Wander, F. Herbert & G. Copeland, eds. 1984).

[9] See, e.g., H.R. Comm. on Rules, 97th Cong., 2d Sess., A History of the Committee on Rules (Comm. Print 1983).

[10] See generally A. Maass, Congress and the Common Good 54-63 (1983).

[11] A few powerful committees -- and especially their chairmen, selected on the basis of seniority -- controlled the congressional agenda in ways that caused other members to feel disenfranchised. The chairmen dominated the committees through their power to control the agenda, the staff, and the existence and composition of subcommittees. Davidson, Subcommittee Government: New Channels for Policy Making, in The New Congress 104 (T.Mann & N. Ornstein, eds. 1981).

[12] Two related developments led to reform. First, the chairmen seemed increasingly out of touch with majority views in Congress and the nation. For example, the bottling up of civil rights legislation throughout much of the 1950s and 1960s exacerbated frustration with the seniority system. Second, the composition of Congress was changing. Increased turnover made the membership of both houses markedly more junior. Mann, Elections and

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House of Representatives, under the aptly named "subcommittee bill of rights," a majority of a committee (instead of the chairman) now determines the number and jurisdiction of subcommittees.[13] In the Senate, informal assurances to each Senator of at least one good committee assignment have resulted in a subcommittee chair for most majority Senators.[14]

Because a subcommittee chairmanship provides a platform for political advancement, committee members have an incentive to create many subcommittees.[15] Not surprisingly, subcommittees have proliferated; the number in the House has risen by a third.[16] The shift of power to the subcommittees has been real: the committees often ratify their action, and have not coordinated subcommittee action firmly.[17] Increasing the number of semiautonomous subunits necessarily makes it more difficult for the chamber to control its possesses.[18] Policy coordination, which is difficult enough for a body with a very crowded agenda, suffers.[19]

Recent congressional studies of the committee system have recommended reducing the number of committees and broadening their jurisdiction.[20] These reforms have languished due to

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12 *Change in Congress*, in T. Mann & N. Ornstein, *supra* note 11, at 37. New members not planning to spend a lifetime in Congress were unwilling to serve an extended apprenticeship before assuming power.

[13] Davidson, *supra* note 11, at 108. Also, there are limits to the number of chairmanships anyone can hold; previously, one person could chair multiple subcommittees.

[14] Malbin, *Delegation, Deliberation, and the New Role of Congressional Staff*, in T. Mann & N. Ornstein, *supra* note 11, at 140.

[15] M. Fiorina, Congress, Keystone of the Washington Establishment 62-67 (1977).

[16] A. Maass, *supra* note 10, at 62; Davidson, *supra* note 11, at 109. A concomitant increase in congressional staff

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[17] A. Maass, *supra* note 10, at 62-63.

[18] The difficulty of legislating has risen: even if the committees usually ratify subcommittee action,

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[19] Ornstein, *The House and the Senate in a New Congress*, in T. Mann & N. Ornstein, *supra* note 11, at 379.

[20] *See, e.g.*, H.R. Select Committee on Committees, *Final Report*, 96th Cong., 2d Sess. (1980).

the reluctance of those controlling the present committees and subcommittees to give up their power. In the meantime, the fragmentation of oversight is sometimes extreme. For example, the Environmental Protection Agency reports to 34 Senate and 56 House committees and sub-committees.[21] So conducted, congressional oversight cannot hope to send an agency consistent signals about policy.[22]

Even if Congress does succeed in improving its own capacities for coordinating policy, much latitude -- and need -- will remain for the executive to act interstitially under the mass of statutes as they exist at any given time. One primary impetus for such activity is the likelihood of a disparity between theories of regulation held by the administration and the existing body of statutes and regulations. For the ebb and flow of federal regulation has been considerable in recent decades. The 1970's saw a surge of new "social" regulatory statutes promoting health and safety in broad sectors of the economy.[23] These programs encountered complexities unknown to the older "economic" regulation, which controlled entry and prices in certain industries.[24] We entered an "age of rulemaking" and began developing administrative law to control the new programs.[25] By the end of the '70s, however, a movement toward deregulation was evident. Long-simmering dissatisfaction with the inefficiencies of traditional economic regulation provided an early impetus.[26] But there was also substantial reaction

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[16] has occurred, mostly in the subcommittees. Malbin, supra note 14, at 140-42.

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[18] legislation is still at peril at both stages of consideration.

[21] National Academy of Public Administration, Panel on Congressional Oversight of Regulatory Agencies, Draft Report 39 (1988). The Panel is considering a number of

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[22] See Bruff, Legislative Formality, Administrative Rationality, 63 Tex. L. Rev. 207 (1984).

[23] See generally Rabin, Federal Regulation in Historical Perspective, 38 Stan. L. Rev. 1189, 1278-95 (1986).

[24] C. Schultze, The Public Use of Private Interest 9-12 (1977).

[25] For the quoted phrase, and the temper of the times, see Wright, The Courts and the Rulemaking Process: the Limits of Judicial Review, 59 Corn. L. Rev. 375 (1974).

[26] See, e.g., 6 Senate Comm. on Governmental Affairs, Study on Federal Regulation, Framework for Regulation (1978).

against the stringent new programs of social regulation, because they created large redistributions and had inefficiencies of their own.[27] By the late 1980's, a period of experimentation with deregulation had borne fruit in such industries as airlines and banking. Then, to bring the story full circle, calls for "reregulation" followed as the costs of deregulation became evident. Today, there remain widely perceived needs to reconsider statutory policies.[28] Meanwhile, there is pressure to update policy to the extent that statutes permit.

Although some substantive statutory overhaul has resulted, most of the important developments have been more informal or indirect.[29] All three branches of the government have recently tried to improve their capacity to control administration within the parameters of existing statutes. Congress has experimented with various techniques to improve its oversight of the mushrooming bureaucracy.[30] The courts have developed new doctrines to provide closer review of both the substance and procedure of agency action.[31] And soon after enactment of the first major group of health and safety statutes, the Nixon administration initiated the first attempts at executive management of regulation.

Executive oversight should not be designed to transfer statutory discretion from the agencies into the White House. The President's bureaucracy lacks the institutional capacity to take on such responsibilities; indeed, we require the full

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[21] recommendations to Congress to make oversight more systematic, such as the adoption of an overall agenda for the review of statutory authorities.

[27] These effects are described vividly in B. Ackerman & W. Hassler, Clean Coal, Dirty Air (1981); Lilley & Miller, The New "Social Regulation," 47 The Public Interest 49 (1977).

[28] Calls for reform have come from across the political spectrum. See, e.g., G. Eads & M. Fix, Relief or Reform? Reagan's Regulatory Dilemma (1984); S. Breyer, Regulation and its Reform (1982); M. Weidenbaum & R. Penoyer, The Next Step in Regulatory Reform: Updating the Statutes (1983); Lilley & Miller, supra note 27.

[29] See generally Strauss, Regulatory Reform in a Time of Transition, 15 Suffolk U. L. Rev. 903 (1981).

[30] See generally the valuable six-volume overview by the Senate Committee on Governmental Affairs, Study on Federal Regulation (1977-78).

[31] Rabin, supra note 23, at 1295-1315; Scalia, Vermont Yankee. The APA, the D.C. Circuit, and the Supreme Court, 1978 Sup. Ct. Rev. 345

existing resources of the agencies to discharge them. Nor would Congress be likely to ratify such a transfer. Instead, there is a place for micromanagement: probing the agency's fact and policy judgments and ensuring that the agency considers factors of general importance to the President's policies, to the extent permissible by law.

Congress has recognized both the need for coordination of government policy and the President's unique capacity to provide it. A number of statutes confer managerial authority on the President. Their existence feeds the current debate over the President's power to control executive policymaking in statutory interstices. They also serve to show how Congress can go about creating and confining executive coordinating powers.

Since enactment of the Budget and Accounting Act of 1921, the President has been responsible for compiling the yearly budget for the federal government and submitting it to Congress of its consideration. In general, the Office of Management and Budget controls both the budgetary and legislative requests of federal agencies, including the independent agencies. As a practical matter, OMB derives considerable leverage from this review power. Congress has occasionally granted an exception from one or both of the requirements, however.[32]

OMB also has power to control the agencies' demands for information from the public, under the Paperwork Reduction Act of 1980.[33] The independent agencies may overrule OMB directives under this statute by majority vote.[34] The component of OMB that administers the Paperwork Reduction Act, the Office of Information and Regulatory Affairs (OIRA), also administers the President's program for coordinating policymaking.[35]

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[32] E.g., 15 U.S.C. § 2076k (Consumer Product Safety Commission). The procedures for submittal and clearance of agency requests are set forth in OMB Circular A-19 (rev. 1979).

[33] Pub. L. No. 96-511, 94 Stat. 2812 (codified in scattered sections of 5, 20, 30, 42, and 44 U.S.C.).

[34] 44 U.S.C. § 3507(c).

[35] Stormy relations between OIRA and Congress due to the executive orders have led Congress to subject the head of the office to advice and consent. Pub. L. No. 99-591, Oct. 30, 1986. For OIRA's early history, see O'Reilly, Who's On First?: The Role of Management and Budget in Federal Information Policy, 10 J. Legis. 95, 97-98, 111-115 (1983).

III. *The Evolution of Presidential Management Programs*

The first executive oversight program for rulemaking was the Nixon administration's "Quality of Life" review.[1] It was announced as an interagency review of proposed regulations dealing with environmental quality, consumer protection and other aspects of public health and safety. In practice the Quality of Life program focused almost exclusively on regulations of the Environmental Protection Agency. EPA's summary of a new rule and its possible alternatives were sent to reviewing agencies (such as the Council on Wage & Price Stability), which had four weeks to comment, unless OMB extended the time.[2] The OMB staff integrated the comments and criticisms and transmitted them to EPA. The process sometimes prolonged rulemaking for many months. Quality of Life review brought outside views of regulatory costs and alternatives to EPA, with some effects on its policymaking.[3]

President Ford's Inflation Impact Statement program focused on the fiscal impact of regulations. By Executive Order 11821, he authorized OMB to promulgate criteria for agencies to use in determining which proposals were "major" in their effects upon the overall economy.[4] The agency's rulemaking staff then prepared an Inflation Impact Statement outlining the costs of the rule, and furnished it to OMB.[5] It soon became clear,

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[1] The Quality of Life program began in June 1971. It is discussed in J. Quarles, Cleaning Up America: An Insider's View of the Environmental Protection Agency 117-142 (1976); *Executive Branch Review of Environmental Regulations: Hearings Before the Subcommittee on Environmental Pollution of the Senate Committee on Environment and Public Works*, 96th Cong. 1st Sess. 60, 61 (1979) (statement of John Quarles, former Deputy Administrator, EPA).

[2] Subcomm. on Oversight of House Comm. on Interstate and Foreign Commerce, Federal Regulation and Federal Regulatory Reform, H. Doc. No. 134, 94th Cong., 2d Sess. 506 (1976).

[3] For an example of a major EPA regulation that was affected by the review program, *see* Ethyl Corp. v. EPA, 541 F.2d 1 (D.C. Cir.) (en banc), *cert*. *denied*, 426 U.S. 941 (1976). In early 1977, the incoming Carter administration terminated the program. *See Hearings*, *supra* note 1 at 63-66. It was not replaced, although important EPA rules attracted ad hoc attention from the White House. This involvement was upheld in Sierra Club v. Costle, 657 F.2d 298 (D.C. Cir. 1981).

[4] 3 C.F.R. 926 (1971-75 Compilation), *modified by* Exec. Order No. 11949, 3 C.F.R. 161 (1976).

[5] OMB Circular No. A-107 (January 28, 1975) "Evaluation of the Inflationary Impact of Major Proposals for

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however, that a decentralized process that left the primary responsibility for impact assessment to the agencies would not affect policy choices as much as would external review. It was charged that the Inflation Impact Statements were post-hoc justifications for decisions already reached, rather than actual restraints on the excessive inflationary cost of rules.[6]

In 1978, President Carter issued Executive Order No. 12044 requiring detailed regulatory analyses of proposed agency rules and review by the Executive Office of the President.[7]

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[5] Legislation and the Promulgation of Regulations or Rules," instructed agencies to include in the evaluation they gave OMB:

> an analysis of the principal cost or other inflationary effects of the action ...a comparison of the benefits to be derived from the proposed action with the estimated costs and inflationary impacts ..., and a review of alternatives to the proposed action that were considered ....

[6] O'Reilly & Brown, In Search of Excellence: A Prescription for the Future of OMB Oversight of Rules, 39 Ad. L. Rev. 421, 427 (1987); Staff of the Council on Wage & Price Stability, An Evaluation of the Inflation Impact Statement Program 59 (1976).

[7] 43 F.R.12661 (March 24, 1978). For "major" regulations, regulatory analysis was to contain:

> a succinct statement of the problem; a description of the major alternative ways of dealing with the problem that were considered by the agency; an analysis of the economic consequences of each of these alternatives and a detailed explanation of the reasons for choosing one alternative over the others.

President Carter explained:

> Regulation has a large and increasing impact on the economy. Uncertainty about upcoming rules can reduce investment and productivity. Compliance with regulations absorbs large amounts of the capital investments of some industries, further restricting productivity. Inflexible rules and massive paperwork generate extra costs that are especially burdensome for small businesses, state and local governments, and non-profit groups. Regulations that impose

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President Carter's Regulatory Reform Message to the Congress, March 26, 1979, p.3. He also ordered that regulations be as simple and clear as possible, and that they not impose unnecessary burdens. To give adequate public notice of agency actions, he created a semiannual agenda of significant regulations under development or review that awaited approval by the head of the agency. OMB subsequently issued guidance to the agencies on how to perform a regulatory analysis.[8] President Carter then created the Regulatory Analysis Review Group (RARG), composed of representatives from the principal economic and regulatory agencies. RARG's purpose was to review a limited number of regulatory analyses having substantial economic impact. Its four- member Executive Committee included OMB and the Council of Economic Advisors as permanent members; the other two memberships rotated every 6 months among the cabinet departments (except State and Defense) and the Environmental Protection Agency. RARG received staff support from the CEA and the Council on Wage and Price Stability (COWPS). It analyzed only the most important half dozen proposed regulations each year. In the RARG review process, reports were drafted by CEA and COWPS staff, commented on and agreed to by the permanent RARG members, and issued in final form for agency consideration.[9]

Also, President Carter created the Regulatory Council, a group consisting of the heads of regulatory agencies.[10] The

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[7] needless costs add to inflation.

> Our society's resources are vast, but they are not infinite. Americans are willing to spend a fair share of those resources to achieve social goals through regulation. Their support falls away, however, when they see needless rules, excessive costs, and duplicative paperwork. If we are to continue our progress, we must ensure that regulation give Americans their money's worth.

[8] November 21, 1978, Memorandum to the Heads of Departments and Agencies, "Regulatory Analysis," from Wayne G. Granquist, Associate OMB Director for Management and Regulatory Policy.

[9] From 1977 to 1980, in support of RARG's efforts, COWPS filed 18 reports with 8 departments and agencies. Also, during the same period, COWPS issued 180 other reports (filings, letters, and testimony) commenting on programs and individual regulations. Hopkins, Lenard, Morrall &

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[10] Memorandum for the Heads of Executive Departments and Agencies, entitled "Strengthening Regulatory Management," dated October 31, 1978.

Council's principal function was to develop and publish semiannually the Calendar of Federal Regulations, which provided analytical synopses of 120-180 major regulations under development that were likely to have substantial economic or public impact. The Council also assisted regulators in developing cost-effective and consistent regulations. The Council then used the Calendar to help identify relationships among upcoming rules, and to develop coordinated plans for dealing with any significant interjurisdictional regulatory issues.[11] The Council also undertook numerous studies and projects designed to improve the regulatory process.

The Ford and Carter precedents influenced the Regulatory Reform bills drafted, but never enacted, between 1978 and 1981.[12] These bills foreshadowed OMB's subsequent role in the Reagan administration. The Office of Information and Regulatory Affairs within OMB was created by the Paperwork Reduction Act, a spinoff from the regulatory reform bills.[13] The Act's more stringent requirements for agency justification of records and data collection provide a statutory basis for OIRA to involve itself in the detail of new agency rules, because the rules frequently require submissions, reports, and surveys. This was the formal beginning of an institutional OMB structure for rulemaking oversight. Also, all of the major bills gave key roles to OMB in oversight. The Reagan administration borrowed from the bills in the drafting of its

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[9] Pinkston, A Review of the Regulatory Interventions of the Council on Wage and Price Stability, 1974-80, Table I, page 2.

[11] See testimony of OMB Director James T. McIntyre, Jr., CEA Chairman Charles L. Schultze, and EPA Administrator Douglas Costle in Regulation Reform Act of 1979, Hearings before the Subcommittee on Administrative Law and Governmental Relations, House Judiciary Committee, Serial No. 41, November 7, 1979, pp. 3- 271.

[12] See, e.g., Senate Comm. on the Judiciary, The Regulatory Reform Act. S. Rep. No. 284, 97th Cong. 1st Sess. 69 (1981); Senate Comm. on Governmental Affairs & Senate Comm. on the Judiciary, Reform of Federal Regulation, S. Rep. No. 1018, 96th Cong. 2d Sess., pt. 1, at 17 (1980)(Joint Report); House Comm. on the Judiciary, Regulation Reform Act of 1980, H. Rep. No. 1393, 96th Cong., 2d Sess. 3 (1980). The bill passed the Senate. 128 Cong. Rec. S2713 (daily ed. Mar. 24, 1982), but it died in the House. See, e.g., 128 Cong. Rec. E4449.

[13] The Paperwork Reduction Act, 44 U.S.C. §§ 3501-3520 (1982), was passed as the only part of the package of Senate Government Affairs bills to have been relatively noncontroversial, while the regulatory reform bills stalled in that committee. The office was established under 44 U.S.C. §3503 (1982).

first executive order in the first month after the change of administrations in 1981.

The Reagan administration's program for oversight of regulation is the most ambitious to date.[14] Executive Order No. 12,291, "Federal Regulation,"[15] requires executive agencies, to the extent permitted by statute, to observe cost-benefit principles in implementing regulations. The order requires executive agencies to evaluate proposed "major rules" (those with a significant effect on the economy) according to a prescribed "regulatory impact analysis." The central innovations of Executive Order No. 12,291 are the mandatory character of its substantive requirements and its system for their enforcement by OMB.

Section 2 of the order requires agencies, to the extent permitted by law, to "adhere" to five general principles "[i]n promulgating new regulations, reviewing existing regulations, and developing legislative proposals concerning regulation." These principles require agencies to base administrative decisions on "adequate information concerning the need for and consequences of proposed government action" and to set regulatory objectives, order regulatory priorities, and undertake regulatory action in a way that will maximize the net benefits to society when costs and benefits are compared.

Section 3 of the order requires agencies to issue preliminary and final Regulatory Impact Analyses (RIA's) in connection with "major rules." An RIA must include statements of the anticipated costs and benefits of the proposed major rule, the anticipated incidence of those costs and benefits, the net anticipated benefits of the regulation, and other potentially more cost-effective regulatory possibilities, with an explanation, if appropriate, of the legal reasons why the most cost-effective means of achieving the anticipated benefits cannot be adopted. The cost-benefit analysis mandated by the order expressly requires the inclusion of beneficial or adverse regulatory effects that cannot be quantified in monetary terms.

On their face, these provisions do not dictate particular regulatory decisions. The terms "cost" and "benefit" are not defined by the order, and the inclusion of unquantifiable costs and benefits in the required calculus can afford agencies significant discretion. The section 2 principles are, however, expressly intended to require agencies to weigh competing values in a particular way and to be prepared to justify regulatory decisions according to a generally prescribed form of analysis. In this sense, section 2 is not neutrally "procedural." Its requirements would be futile if agencies did not treat them as foreclosing at least some regulatory possibilities.

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[14] *See generally* Shane, *Presidential Regulatory Oversight and the Separation of Powers: The Constitutionality of Executive Order No. 12,291*, 23 Ariz. L. Rev. 1235, 1235-42 (1981); *see also* Sunstein, *Cost-Benefit Analysis and the Separation of Powers*, 23 Ariz. L. Rev. 1267 (1981).

[15] 3 C. .R. 127 (1982).

An agency must transmit each proposed major rule, together with a preliminary RIA, to the Director of OMB sixty days prior to the publication of any notice of proposed rulemaking. OMB then has sixty days to review such a submission, and may require the agency to consult concerning the preliminary RIA and notice of proposed rulemaking, and to refrain, subject to judicial or statutory deadlines, from publishing its proposal until review is concluded. The order provides, however, that these review powers shall not "be construed as displacing the agencies' responsibilities delegated by law."

Subsequently, Executive Order No. 12,498 was promulgated to establish a "regulatory planning process."[16] The order requires the head of each executive agency to send OMB a "draft regulatory program" that describes "all significant regulatory actions" to be undertaken within the next year. OMB reviews the plan for consistency with administration policy, and a final plan is published. Executive Order No. 12,498 supplements the prior order by giving agency heads and OMB more power over the early states of the regulatory process. This reduces the capacity of agency staff components to develop a regulatory initiative to the point that it develops a constituency -- and a life -- of its own. Professors Strauss and Sunstein elaborate this point:[17]

> [The orders respond to the] perception that agency heads are, to an undesirable degree, the captives of their own staffs rather than politically powerful managers of agency business. Courts have created a number of techniques to attempt to respond to this problem, including review to ensure that the benefits of regulation are roughly commensurate with the costs. The value of such techniques is, however, severely diminished by institutional limits of the courts, which are not well-equipped to calculate the costs and benefits of regulatory initiatives and are incapable of imposing a hierarchical or coordinative structure. The orders represent an effort to deal with the general problem of uncoordinated and insufficiently accountable administrative decisions.
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> While the orders on their surface mark major enhancement of presidential authority, a significant element of their attractiveness lies in their potential to expand the effective authority,

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[16] 3 C.F.R. 327 (1986); *see* Note, *Presidential Policy Management of Agency Rules Under Reagan Order 12,498*, 38 Ad. L. Rev. 63 (1986).

[17] *The Role of the President and OMB in Informal Rulemaking*, 38 Ad. L. Rev. 181, 187-88 (1986).

accountability, and oversight capacity of the agency head. This potential is particularly strong for Executive Order 12,498. Requiring the development of an agency regulatory plan should have the same effect on the regulatory side as requiring agency presentation of a budget request does for fiscal planning. It will provide an annual opportunity for the agency head to focus on the work of her agency in a planning rather than a reactive mode, stressing broad vision and priority setting, and involving her early enough that one may expect her to have a significant impact on options considered. Fewer staff deals will have been cut. The requirement of early disclosure of plans -- through ventilation of alternatives (in the case of Executive Order 12,291) and annual statement of the regulatory plan (in the case of executive Order 12,498) -- is thus a means of ensuring that regulatory policy is set by agency heads rather than staffs. In this respect, the two orders may be understood, not only as efforts to enhance presidential or OMB power as against agencies, but also as a means of enhancing the agency head's effective control over her staff.

Like the Reagan orders, any permanent regulatory management program must address inherent tensions between political appointees and the career bureaucracy. That topic follows.

IV. OMB and the Agencies: Comparative Competence and Power.

A. Vantage Points: The Place of OMB and the Agencies in the Executive.

The Office of Management and Budget is the President's principal institutional means for supervising the federal bureaucracy. Recast from the old Bureau of the Budget, OMB consists of a few hundred civil servants (most of them budget officers) and a growing cadre of political appointees at the top. Since the 1970's, OMB staffing has become increasingly political, with a sharp upsurge from 9 to 25 Schedule C political appointees in the first Reagan term alone.[1] The Reagan administration also kept close central control on political appointments within the agencies.[2] Both developments respond to the growth of the regulatory bureaucracy since 1970. They reflect presidential efforts to control policy both by designing new functions for OMB and by using traditional executive powers more effectively.

Budget functions have long dominated OMB, to the dismay of some political scientists, who yearn for more attention to management.[3] In budgeting, OMB's classic stance has been the skeptical reviewer of requests from agencies that are always wanting "too much." Indeed, a famous theory of bureaucratic behavior holds that the principal endeavor of agencies is to expand their budgets, in search of the power and perquisites that more money can buy.[4] Whether or not this theory fits reality, to the extent that it is accepted within OMB, it affects OMB's behavior.

Attitudes born of the budget process probably carry over to supervision of rulemaking by OMB's Office of Information and Regulatory Affairs (OIRA).[5] True, the functions are somewhat different--no formal "regulatory budget" yet exists, "appropriations" for which must be coaxed from Congress. Although the direct tradeoffs between scarce federal dollars that characterize the budget process do not occur in oversight of regulation, the perspective of anyone working in OMB is determined by its placement at the apex of the executive branch. An office that sees the full scope of federal regulation must be impressed by its net burdens, and is likely to doubt that any particular rule is indispensable to national welfare. Analogies to budgeting, however, can ignore the principal differences between these functions: unlike regulatory review, budget requests are not confined by preexisting statutory standards, and they lead to automatic legislative resolution of policy issues.[6]

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[1] Sen. Comm. on Environment and Public Works, Office of Management and Budget Influence on Agency Regulations, 99th Cong., 2d Sess. 20 (Comm. Print 99-156, 1986).

[2] Pfiffner, Political Appointees and Career Executives: The Democracy-Bureaucracy Nexus in the Third Century, 47 Pub. Admin. Rev. 57, 59 (1987), quoting Pendleton James, Director of the White House Personnel Office: "We handled all the appointments: boards, commissions, Schedule C's .
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[3] See generally, e.g., Benda & Levine, OMB and the Central Management Problem: Is Another Reorganization the Answer?, 46 Pub. Admin. Rev. 379 (1986).

[4] W. Niskanen, Bureaucracy and Representative Government (1971).

[5] There is also some functional overlap. OMB reviews rules to ensure that fiscal year and administration budgetary
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For similar reasons of perspective, agency personnel are likely to view OMB as institutionally overcautious about regulation. Focusing on the statutory missions committed to them, bureaucrats lack any incentive to view their own regulations in competition with other claims on scarce national resources. Therefore, any system for central oversight of regulation will produce conflict between the regulators and their overseers, regardless of the politics of the administration in power.

OMB Director James C. Miller III has argued that decentralized regulation advantages control by well-organized interests.[7] This conclusion requires some qualification. The pressures on agencies from all three branches of government and private interest groups foster a quite complex and not readily predictable set of bureaucratic motivations. Traditional theories that agencies are subject to capture by their regulated interests do not account for the complex

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[2] . . . If you are going to run the government, you've got to control the people that come into it."

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[5] goals are achieved. This review centers on entitlements programs, such as student loans and health care financing.

[6] Strauss & Sunstein, supra note III-17, at 195.

[7] Miller, Shughart & Tollison, A Note on Centralized Regulatory Review, 43 Pub. Choice 83, 86 (1984); see also Noll, Reforming Regulation 40-42 (1971).

constituencies and expanded rights of participation that characterize modern regulation.[8] For example, the Environmental Protection Agency encounters effective pressure from both industry and environmental groups. There does seem to be a tendency to compromise among effectively organized interest groups, which often results in service to a fairly broad range of interests.[9]

Director Miller argues that centralized review of regulation limits special interest influence in two ways. First, it adds lobbying costs while potential gain remains the same. Second, since reviewers deal with everyone, there is no reason to expect capture by anyone. Again, qualification is necessary. OMB is naturally more permeable to an administration's friends than to its enemies. Since the issue is marginal gain from the presence of additional process, any group that expects a friendlier reception from OMB than from the agency will favor central review, and will be willing to expend resources in hopes of influencing its outcome. This suggests that the way in which OMB review is actually performed will determine its tendency to reinforce or dampen special interest influence.

Executive oversight also serves separation of powers goals. Congressional oversight of regulation is constant. The President needs to assert his own claims over the executive branch to forestall the formation of "iron triangles" by which agencies, interest groups, and congressional committees might otherwise gain control of regulatory policy. A President needs to be especially concerned with the formation of alliances between agency staff who oppose his policies and committees in a house of Congress that is organized by the party out of power.

Because congressional oversight is decentralized, it does not usually send consistent signals to agencies. Only the executive branch, with its heirarchical organization, has the capacity to formulate a consistent set of instructions to the bureaucracy. This provides an opportunity to promote values held by the administration, thereby maximizing the political accountability of regulation.[10]

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[8] Robinson, The Federal Communications Commission: An Essay on Regulatory Watchdogs, 64 Va. L. Rev. 169, 190-91 (1978).

[9] See generally Bruff, Legislative Formality, Administrative Rationality, 63 Tex. L. Rev. 207 (1984).

B. Analysis of the Costs and Benefits of Regulation.

The requirement of Executive Order No. 12291 that agencies perform regulatory analyses to support their rules had two sources. One was the similar analysis required by executive orders in previous administrations. The other was an existing need to explain the basis for rules to survive judicial review.[11] These developments had revealed the major weakness of controlling discretion by means of formal analysis. Either the initial analyst or the reviewing entity may disguise a predetermined substantive preference in the garb of considered discourse.[12] Counteracting this weakness should be a major purpose of those who guide the activities of both analysts and reviewers.

Executive review of regulatory analysis can promote its consistent performance in ways that judicial review cannot, for two reasons. First, the executive can review all analyses according to a single set of criteria, while the courts are decentralized.[13] Second, courts do not attempt to require the "best" analyses, just acceptable ones. The executive can pursue both quality and consistency in the agencies' analytic techniques.

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[10] See Mashaw, *Prodelegation: Why Administrators Should Make Political Decisions*, 1 Yale J. of Law, Econ. & Org. 81 (1985).

[11] *See generally* Sunstein, *Deregulation and the Hard-Look Doctrine*, 1983 Sup. Ct. Rev. 177; Garland, *Deregulation and Judicial Review*, 98 Harv. L. Rev. 505 (1985).

[12] *See* Bruff, *supra* note IV-x, at 238-40. This weakness of judicial review was identified very early; *see* SEC v. Chenery Corp., 318 U.S. 80, 99 (1943) (Black, J., dissenting). For its presence in an earlier executive order program, see text at note III-6 *supra*.

[13] For the difficulties the courts face in adumbrating consistent administrative law commands to agencies, *see* Strauss, *One Hundred Fifty Cases Per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 Colum. L. Rev. 1093 (1987).

The executive order requires cost-benefit analysis, which has always been controversial for several reasons.[14] First, the uncertainty and difficulty of the process may render it especially vulnerable to manipulation in service of predetermined outcomes. Second, it tends to be biased against regulation, because the direct costs of a rule are likely to be more visible and quantifiable than are its benefits.[15] Third, cost-benefit is usually the province of economists, whose professional orientation favors private ordering and clashes with that of health scientists, who are more risk-averse to possible threats to public health.[16]

What matters most about cost-benefit analysis is the spirit in which it is performed. One skeptic concedes that it is valuable if used by an agency "committed to the underlying goals and spirit of a regulatory program," rather than to mask anti-regulatory bias.[17] Its defenders point out that its stated purpose is to ask questions about rules that any rational observer would address.[18]

Cost-benefit analysis can reveal and counteract biases that excessively favor regulation. Two persisting controversies between OMB and the agencies have concerned analytic techniques with strong implications for the desirable stringency of regulation. Agencies have pressed for the use of multiple conservative assumptions in environmental decisions, which favor strict regulation. OMB has urged the use of discount rates for future illnesses, which imply relaxed regulation.[19]

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[14] See, e.g., Markovits, Duncan's Do Nots: Cost-Benefit Analysis and the Determination of Legal Entitlements, 36 Stan. L. Rev. 1169 (1984); Kennedy, Cost-Benefit Analysis of Entitlement Problems: A Critique, 33 Stan. L. Rev. 387 (1981).

[15] See McGarity, Regulatory Analysis and Regulatory Reform, 65 Tex. L. Rev. 1243, 1279-83 (1987).

[16] Id. at 1266.

[17] NAPA Report at 44 (Separate views of Richard Wegman).

[18] See, e.g., Scalia, Regulatory Review and Management, Regulation, Jan.-Feb. 1982, at 19-20.

[19] Office of Management and Budget, Interim Regulatory Impact Analysis Guidance (June 13, 1981).

A less controversial technique is cost-effectiveness analysis. It avoids direct weighing of such imponderables as the value of life by simply asking whether a given strategy is the cheapest means to a posited goal. Present regulations vary greatly by this criterion.[20] Its use can help to equalize burdens of regulation, minimizing differences in costs to the economy per unit of gain, by such measures as statistical lives saved. Much of the existing disparity in approach, however, is built into the statutes, due to their episodic enactment or because other values intrude, such as equalizing risks to groups of workers regardless of cost differences.[21]

The role of regulatory analysis in undergirding an agency's regulations-- and in informing judicial review-- is shown by several examples from rulemaking by the National Highway Traffic Safety Administration (NHTSA). In *Center for Auto Safety v. Peck*,[22] the court upheld NHTSA's relaxation of its standard for automobile bumper crashworthiness, although the regulation altered previous agency policy. The court relied heavily on the agency's regulatory analysis, which comprehensively analyzed the costs and benefits of nine alternative standards.[23] NHTSA had estimated that requiring bumpers to survive collisions at 2.5mph would yield average net benefits per car of $42 more than the preexisting 5mph standard.[24]

On the other hand, in the celebrated *State Farm* case[25] the Supreme Court held that NHTSA's rescission of its automobile passive restraint regulation was arbitrary. An otherwise comprehensive regulatory analysis had failed to consider a major alternative to rescinding the existing standard: requiring airbags.[26] Thus, requirements for persuasive analysis restrict an agency's discretion to alter a previous policy that was itself carefully justified.

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[20] NAPA Report at 2, 30; *see also* Lilley & Miller *The New "Social Regulation"*, 47 Pub. Interest 49 (1977).

[21] *See* G. Robinson, E. Gellhorn & H. Bruff, The Administrative Process 687 (3d ed. 1986).

[22] 751 F.2d 1336 (D.C. Cir. 1985) (Scalia, J.).

[23] *See also* South Carolina *ex rel*. Tindal v. Block, 717 F.2d 874, 879-84 (4th Cir. 1983), *cert. denied*, 465 U.S. 1080 (1984) (relying on regulatory analyses in upholding rule).

[24] Office of Management and Budget, Regulatory Program of the United States Government, April 1, 1987-March 31, 1988, at xviii.

[25] Motor Vehicle Mfrs. Assn. v. State Farm Mutual Automobile Insurance Co., 463 U.S. 29 (1983).

Cost-benefit analysis has also led NHTSA to impose new regulations. In 1983, the agency required new automobiles to have center high-mounted stop-lamps. The regulation followed field experiments with various types of stop-lamps, and reflected NHTSA's estimate that the ones required would prevent 40,000 injuries and over $400 million in property damage annually, at a cost of $70 million annually.[27]

C. The Nature of OIRA Oversight.

Review of rules within OIRA is generalist in nature. It is performed by "desk officers", who are typically young economists, lawyers, or policy analysts with little prior experience in government or the programs they oversee. Because most review is performed by the individual desk officers, OIRA is rather decentralized. The consistency of desk officer review is reduced by the lack of formal training programs or detailed written instructions on their tasks; on-the-job training is made to suffice. Because OIRA reviews all rules of covered agencies, volume precludes detailed analysis of rules. Desk officers sort new rules to identify the most important, and dispose of most rules quickly.[28]

The goals of review in OIRA recognize that, like any other outside review, executive oversight can make regulation more reasoned by forcing articulation of the basis of proposals. OIRA review is closely similar to the generalist "hard look" review of the courts, which asks whether regulations are persuasively reasoned and consistent with the agency's other policies and its statute.[29] Thus the executive can both pursue optimal policy and search out analytic errors that would otherwise cause problems in court.

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[26] McGarity, supra note IV-15, at 1327.

[27] Office of Management and Budget, Regulatory Program of the United States Government, April 1, 1988-March 31, 1989, at 16, 31.

[28] OMB has not trusted agencies to apply criteria defining rules meriting review.

Of course, it is also possible for OIRA to introduce rather than to remove regulatory defects. A certain amount of tinkering with rules probably results from the efforts of desk officers to justify their own existence.[30] That effect, however, probably attends any scheme for centralized review.

OIRA's principal officers do not expect expertise or research from the desk officers. It would not be sensible to do so, in view of the vastly greater expertise and resources of the agencies. For example, EPA, with a staff of about 10,000, submits all its rules to four desk officers in OIRA, who receive some assistance from other OIRA and budget personnel.[31] These officers have neither the time nor the expertise to evaluate conflicting interpretations of technical data in a rulemaking.

In this system, tension with agency heads is automatic. Since the agency heads are typically not technical experts in their regulatory fields, they have already provided generalized review of a regulation that they send to OMB. Moreover, they regard themselves as cooperative in achieving the goals of the administration that appointed them. The premise of centralized review, then, is that the judgment of the political appointees requires an outside check--that their judgment is affected by exposure to daily pressure from career staff, the interest groups, and congressional committees, or at least by a natural overcommitment to the statutory mission of the agency.[32]

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[29] The NAPA Report, at 38-39, says that the goal is to obtain a "common sense," outside review of the agency's product.

[30] Sen. Comm. Print 99-156, supra note IV-1, at 19-20, quoting a former EPA desk officer at OMB: "A good desk officer does change a rule. To make your mark, you get changes made. I felt kind of funny handing back a rule saying it was consistent [with Executive Order 12291]."

[31] Sen. Comm. Print 99-156, supra note 1, at 18-19.

[32] See Sierra Club v. Costle, 657 F.2d 298, 406 (D.C. Cir. 1981):

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Agency officials have often called for OIRA to be more selective in its review.[33] Thus, OMB is perceived to suffer priority problems. Essentially, the complaint is the one so often lodged against agencies, that there is too much burdensome process and delay with too little result. This reflects on the judgment of desk officers in selecting issues to discuss with agencies. Rules that receive only cursory attention are not much delayed.

OIRA has recently instituted a tracking process for regulations under review. A briefing book for the senior officers gives the status of significant regulations and provides an opportunity to monitor the desk officers. Otherwise, controversy between a desk officer and agency personnel is the mechanism for bringing issues to the attention of senior officers in OIRA and OMB. Thus, although OIRA lacks formal appeals processes, issues percolate up through the bureaucratic chains in the agencies and in OMB until they are resolved.

The presence of OMB's review program has led to the formation of "mini-OMB's" in the agencies to mimic OIRA review, in hopes of forestalling embarrassment from negative comments by OIRA.[34] Some of the conflict that is inherent in the program then shifts into the agencies, where the mini-OMB's (which are usually in the agency head's office) struggle for power with the program offices. This development does add a new level of clearance and delay to the rulemaking process, unless it is offset by speedier OMB review. If the mini-OMB's become a permanent feature of the government scene, OMB may be able to shift its emphasis toward macromanagement issues such as rationalizing statutory authorities.

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32 Our form of government simply could not function effectively or rationally if key executive policymakers were isolated from each other and from the Chief Executive. Single mission agencies do not always have the answers to complex regulatory problems. An overworked administrator exposed on a 24-hour basis to a dedicated but zealous staff needs to know the arguments and ideas of policymakers in other agencies as well as the White House.

[33] NAPA Report at 39.

[34] NAPA Report at 39.

At present, OMB cannot provide much coordination on issues concerning more than one agency, due to lack of resources. Some critics consider the Carter administration's RARG to have been better adapted for in-depth review, on grounds that it provided a mechanism for rethinking statutory schemes, for balancing major regulations with other goals, and for aggregating experience with regulatory analysis. The NAPA study recommended creating a regulatory analysis office for these purposes.[35] At present, however, OIRA does have a group of "superanalysts" review agencies' analyses, in pursuit of improvements in the technique. And whatever advantages the Carter administration process may have had in depth of inquiry were won at the cost of sharply reduced coverage, since only a handful of regulations were reviewed each year.

D. Bargaining in the Shadow of Presidential Power.

Executive Order No. 12291 states that it is not to be construed as "displacing the agencies' responsibilities delegated by law."[36] OMB's formal power, then, is limited to "jawboning" the agencies: arguing over proposals, delaying the issuance of regulations while persuasion is sought, and, ultimately, placing critical comments in the public file, to which the agency must respond. But how does this work in practice? The NAPA study concluded that "OMB arguments are more than advisory but still less than mandatory. The review process is more one of negotiation and accommodation than of agency initiatives being overruled by OMB demands. Agencies are not monolithic, and political appointees frequently differ with career employees."[37]

This assessment seems generally correct, with some qualifications. The system is built for both conflict and compromise. Consider the advantages held by each of the two parties. The agency has an initial advantage because it sets the parameters of the debate. Summary rejection of an agency submission is rare; negotiations usually produce tradeoffs at the margins of the agency proposal (as, indeed, they do in the budget process).[38] The agency also has massive advantages in the size and expertise of its staff, and can respond in depth to any position taken by OIRA. Finally, the agency retains the formal authority to promulgate a rule, and can do so if it is willing to persist in opposing OIRA's point of view. When statutory or judicial deadlines for rulemaking loom, this authority gives agencies considerable leverage with OIRA.

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[35] NAPA Report at 41. The Report also suggested the creation of a parallel office within the General Accounting Office or the Office of Technology Assessment.

[36] Sec. 3(f)(3).

[37] NAPA Report at 26.

OMB, however, has advantages of its own. First, there is the power of persuasion, which varies with the cogency of its positions and the power of the individuals asserting them. Second, OMB can use the threat of further delay to press acceptance of its views. Experience has shown this to be a powerful tool. Third, OMB can play on the allegiance to the administration of senior political appointees in the agency, in an effort to sway them from positions generated by career staff. Here too, OMB has repeatedly demonstrated its practical power. Fourth, OMB's leverage depends on its other powers over the agencies. These are: its budget functions, its statutory power to control requests for information from the public, and, ultimately, a request to the President to remove an uncooperative official.

Much depends on the bureaucratic level that a particular controversy reaches, and on the agency's power within the administration. No OIRA desk officer can realistically threaten to slash an agency's budget, but the OMB Director can. A Deputy Assistant Secretary in an agency cannot realistically threaten to appeal to the President, but the Secretary can. As with other issues in the bureaucracy, continuing controversy over a rule tends to rise up the chain of command in both the agency and OMB, until resolution is reached. Final compromise on a relatively controversial rule will be reached among the senior political appointees in the administration. This does not mean, however, that OMB and the agency will be evenly matched in the bargaining. Several of the agencies whose rules have produced frequent controversy with OMB (EPA, FDA, and OSHA) are headed by subcabinet administrators who lack the "clout" of the old-line cabinet departments such as State and Treasury. With regard to the health and safety agencies, OMB may truly be the "toughest kid on the block,"[39] able to impose its will if its senior officers are persistent.[40]

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[38] See id at 27.

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[39] The quote is from James C. Miller III, head of both OIRA and OMB, in Deregulation HQ: An Interview on the New Executive Order with Murray L. Weidenbaum and James C. Miller III, Regulation (Mar/Apr. 1981), 14, at 22.

[40] Of course, contests for power between agency and White House staff long predated the Reagan administration. See Subcomm. on Employee Ethics and Utilization, House Comm. on Post Office and Civil Service, 95th Cong., 2d Sess., Presidential Staffing--A Brief Overview, 55-61 (1978).

V. Fidelity to Statutory Authority.

A. Reconciling Statutory Commands with Administration Preferences: "Regulatory Relief" in the Reagan Administration.

Although the Reagan administration's regulatory management program is constitutional on its face, its administration has the potential to transgress substantive or procedural statutory limits.[1] Of course, all executive activity carries the potential for straying beyond legal limits. The question concerning this particular program is whether one of its announced purposes has placed an undue strain on fidelity to statutory requirements. That purpose is deregulation, which, if pursued for its own sake rather than resulting from a careful review of regulations, can undermine compliance with statutes that mandate regulation.[2]

Both of the executive orders that create the present regulatory management system include among their purposes "to reduce the burdens of existing and future regulations." Indeed, the Reagan administration's first day saw creation of the high-visibility Task Force on Regulatory Relief, with the Vice President as chair and cabinet officers as members. Its final report in 1983 claimed to have "rationalized the rulemaking process and slowed the growth of new rules."

This theme has persisted. President Reagan's introduction to his Regulatory Program for 1988-89 states his belief "that American life is burdened by too much regulation and that true regulatory reform must involve regulatory reduction."[3] The President's message goes on, however, to endorse "the development of useful regulations that will increase benefits to society as a whole", and to express confidence that his successor "will want to continue this endeavor to serve the public interest by insisting that regulatory activity be productive."[4]

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[1] See generally Office of Legal Counsel, Department of Justice, Proposed Executive Order Entitled "Federal Regulation", 5 Op. O.L.C. 59 (1981); See Symposium, Cost-Benefit Analysis and Agency Decision-Making: An Analysis of Executive order No. 12,291, 23 Ariz. L. Rev. 1195 (1981).

[2] A sign of deregulation for its own sake in the Reagan program is the use of categorical waivers of OMB review for deregulatory actions, for example relaxations of pesticide tolerances and the deletion of listed toxic water pollutants. See Office of Management and Budget, Regulatory Program of the United States Government, 1985-86, at 581.

[3] Office of Management and Budget, Regulatory Program of the United States Government, 1988-89, at vii.

[4] Id. at viii.

If a regulatory management program is to succeed, it must not cause rules to be invalidated by reviewing courts. Recent Supreme Court decisions have set the parameters for judicial review of rulemaking. The Court has tried to achieve two somewhat inconsistent purposes--to allow political oversight to operate freely, yet to bind final agency decisions to law. The two most important cases illustrate the tensions. In *Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*,[5] the Court considered the amount of latitude that courts should give to agencies' interpretations of their governing statutes. It allowed the EPA to reverse preexisting policy in favor of an approach to air pollution that met the administration's efficiency criteria.[6] In a departure from earlier cases, the Court called for a determination "whether Congress has directly spoken to the precise question at issue" in the text or legislative history of a statute. If Congress has spoken clearly, its will governs, but if the statute is "silent or ambiguous," the agency's interpretation prevails if "reasonable." The Court's rationale for endorsing the interpretive authority of agencies emphasized political accountability. It said that an agency may "properly rely upon the incumbent administration's views of wise policy to inform its judgments."

Although controversy surrounds *Chevron*, it has had considerable impact on the lower courts.[7] *Chevron* altered prior law by denying courts the power to decide issues of statutory interpretation that depend on the overall structure and purposes of the statute. *Chevron*'s critics regard that role as a traditional preserve of the judiciary.[8] Perhaps because of that tradition, the Court's later cases have evinced some doubts about the sweep of *Chevron*.[9]

The Court's earlier decision in *Motor Vehicle Manufacturers Assn. v. State Farm Mutual Automobile Insurance Co.*[10] invalidated NHTSA's attempt to conform its policy to administration goals by rescinding its passive restraints regulation. One can reconcile the two cases on grounds that in State Farm the agency insufficiently explained the fact and policy bases of its action, whereas in Chevron the agency passed that test. Nevertheless, by endorsing active judicial review of an agency's support in the administrative record for any change in the regulatory status quo, the Court slowed administrative efforts to alter existing regulations.[11]

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[5] 467 U.S. 837 (1984).

[6] *See generally* Landau, Chevron, U.S.A. v. NRDC: *The Supreme Court Declines to Burst EPA's Bubble Concept*, 15 Envir. L. 285 (1985).

[7] *See generally* Starr, *Judicial Review in the Post*-Chevron *Era*, 3 Yale J. Reg. 183 (1986); Pierce, *Chevron and its Aftermath: Judicial Review of Agency Interpretations of Statutory Provisions*, 41 Vand. L. Rev. 301 (1988).

[8] *See, e.g.*, Breyer, *Judicial Review of Questions of Law and Policy*, 38 Admin. L. Rev. 363 (1986).

[9] INS v. Cardoza-Fonseca, 107 S.Ct. 1207 (1987); NLRB v. United Food & Commercial Workers Union, 108 S.Ct. 413 (1987).

[10] 463 U.S. 29 (1983); see text at notes IV-25-26 *supra*.

From the outset the Reagan Administration's regulatory relief emphasis has been difficult to reconcile with the legislative history of some of the most stringent health and safety statutes. These statutes were passed in the early 1970's, in an era when congressional sensitivity to the cost of regulation was low.[12] In the absence of comprehensive reform of these statutes, which has not occurred, the administration has struggled to accommodate its philosophy of government with statutory commands premised on a need for aggressive regulation. As Chevron and State Farm illustrate, the results in court have been mixed.

Not surprisingly, most of the controversy that has surrounded the regulatory management program has centered on its relation to these statutes. Although the real disagreement usually concerns the substance of regulatory policy, much of the debate has occupied the more neutral ground of procedure.[13] In other contexts, administrative lawyers are familiar with this tendency for procedural debate to mask substantive conflict. For purposes of this report, it creates two difficulties. First, one needs to penetrate the substantive static to identify real issues of procedure. Second, one needs to craft procedures that respond to the potential for tension between statutory requisites and executive preferences.

B. Delay, Deadlines, and Bargaining Power.

The NAPA Report found that the "clearest impact" of the oversight process has been to slow rulemaking; agency personnel complained about it constantly.[14] Of course, delay is part

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[11] See generally Sunstein, supra note IV-11; Garland, supra note IV-11.

[12] See, e.g., Union Electric Co. v. EPA, 427 U.S. 246 (1976) (Clean Air Act); American Textile Mfrs. Inst., Inc. v. Donovan, 452 U.S. 490 (1981) (OSH Act).

[13] For an example of mixed legal and policy concerns in the continuing debate, compare Morrison, OMB Interference with Agency Rulemaking: The Wrong Way to Write a Regulation, 99 Harv. L. Rev. 1059 (1986), with DeMuth &

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[14] NAPA Report at 7, 37.

of the price of any analytic process. In a particular case, whether it is justified by improvements in the final rule is a matter of opinion. Leaving that question aside, I discuss three issues here. First, in the Reagan oversight program, long delays have been common enough to suggest a need to revise applicable administrative deadline and extension provisions. Second, courts have found delay illegal where it contributes to missed statutory deadlines. And third, delay provides both OMB and the agencies a tool to obtain the other's assent to their views.

Executive Order No. 12291 sets short presumptive deadlines for OMB review: 60 days for proposed major rules, 30 days for final ones, and 10 days for all others. Most rules are reviewed within these general parameters--the overall figures for 1981-87 show an average of 32 days for major rules, 18 days for others, and 19 days for all rules.[15] In view of OIRA's small staff and large workload, this overall record is impressive. Still, gross statistics can be misleading for complex or controversial rules. For example, in 1985 the average review time for major EPA rules was 78 days, and for the Department of Labor (where OSHA resides) it was 173 days.[16]

The executive order allows OMB to extend its review indefinitely, absent judicial or statutory deadlines.[17] Controversial rules have been held for periods of up to a year or more. For example, EPA submitted eleven New Source Performance Standards (NSPS) for air pollutants to OIRA for review, between 3 and 13 months before the applicable statutory deadline for their issuance.[18] Negotiations then extended past the deadline for all eleven rules, in one case by a year. This technical violation of both statutory and executive order requisites may not have seemed serious to either EPA or OIRA,

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[13] Ginsburg, *White House Review of Agency Rulemaking*, *id*. at 1075.

[15] 1988-89 Regulatory Program, *supra* note V-3, at 555.

[16] *Id*. Figures compiled at EPA differ somewhat. They showed that in 1985, OMB held major rules for over four months. Sen. Comm. on Environment and Public Works, Office of Management and Budget Influence on Agency Regulations, 99th Cong., 2d Sess. 9 (Comm. Print 99-156, 1986).

[17] Executive Order No. 12291 exempts rules from its process when review would "conflict with deadlines imposed by statute or by judicial order." Sec. 8(a)(2).

[18] Olson, *The Quiet Shift of Power: Office of Management & Budget Supervision of Environmental Protection Agency Rulemaking Under Executive Order 12,291*, 4 Va. J. of Nat'l Res. L. 1 (1984).

because the health and safety statutes contain many rulemaking deadlines that agencies do not meet. Nevertheless, these violations tend to produce hostile reactions in Congress. A congressional oversight report said the NSPS delay was "caused by the need to respond to OMB's questions on cost-effectiveness and to clarify apparent misunderstandings and misinterpretations, by delayed meetings, and by simple inaction and unresponsiveness on the part of OMB."[19]

Review-based delays have also encountered judicial disapproval where they have contributed to an agency's failure to meet statutory deadlines. In Environmental Defense Fund v. Thomas,[20] a district court considered a suit to compel the EPA to comply with a statutory directive that it promulgate rules by March 1, 1985, dealing with hazardous wastes in underground storage tanks. EPA was already beyond this deadline when it sent a proposed rule to OMB on March 4, 1985. The agency may have anticipated that the missed deadline would compel speedy OIRA clearance, but that was not to be. In an April meeting, OIRA pressed EPA to alter its strategy from containing all leaks to one of preventing leaks of wastes that risk analysis identified as threats to health. After more negotiations, OMB cleared the rule in mid-June.

Finding a statutory violation, the court set a new deadline for promulgation of a final rule, compliance with which was not to be prevented by OMB review. Judge Flannery noted that the delay problem was not limited to this rule--interrogatories had revealed that OMB often extended its review even when statutory or judicial deadlines were present. Complaining that the executive order's exemption for rules under deadline is "[a]pparently . . . simply ignored," he declared that OMB review must terminate in time to allow meeting deadlines.

Especially in the presence of statutory deadlines, either OIRA or an agency can use delay to gain leverage. A typical agency complaint occurred in an internal EPA study of the NSPS delays:[21]

> The problem is that OMB has no incentive whatsoever to keep the process moving and no one to which they are accountable for failures of responsiveness. . . . Once a dialogue has begun, OMB tends to repeatedly find new issues each time the last issue is settled, often with long intervening delays. Often, . . . these issues involve questioning the technical judgment of EPA rather than the implications of costs, benefits, and impacts to society.

EPA is correct that the responsibility for issuance of a rule

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[19] Sen. Comm. Print 99-156, supra note V-16, at 31.

[20] 627 F. Supp. 566 (D.D.C. 1986).

[21] Sen. Comm. Print 99-156, supra note V-16, at xvi.

(and, probably, the desire to have one at all) lies principally with the agencies rather than OIRA. This gives OIRA some leverage in any rulemaking. Still, OIRA is accountable within OMB and the administration for its lapses. Any tendency to bring up new issues during review can result from inefficiency in OIRA, and if so can be cured by improved management. Also, it is not easy to identify the borderline between technical judgment and oversight of costs and benefits of a rule.

True, even when delays are long, it is rare for agencies to seek formal appeal of an OIRA position, or to publish a rule in the face of its opposition.[22] An agency contemplating either action would fear worsened relations with OMB, and, possibly, retribution. Therefore, delay caused by OIRA preference can put effective pressure on an agency to accede. Moreover, this pressure arises even when delay in OMB is not a negotiating tactic but a result of the volume of rules and the small size of OIRA's staff.

In the presence of a statutory or judicial deadline, the possibility arises for either OIRA or an agency to pressure the other in a game of "chicken." The agency has the formal responsibility to meet the deadline, and is therefore vulnerable to threats of delay. At the same time, the agency can withhold its own submission to OIRA until a deadline nears, and press for immediate review. Indeed, if an agency is tardy enough, it may escape review entirely.[23]

More definite limits should be placed on the duration of OIRA review, to constrain the relatively infrequent but extended delays that have sometimes interfered with the administration of federal programs. Such limits would presuppose that the marginal utility of OIRA review diminishes as time passes and as the costs of delay increase. Reasonable minds could disagree on the optimal duration of OMB review. One strategy would begin with the presumptive limits in Executive Order No. 12291, which have sufficed for most rules. OIRA would be entitled to a set number of extensions each year, again for a fixed and final period.

Firmer administrative deadlines would inform both sides to the dialogue of the time it will end. Of course, agencies would gain opportunities to stall, hoping to prevail through inaction. The existence of OMB's other powers over agencies, especially in budgeting, should confine this tendency somewhat. For a more sensitive enforcement device, OIRA should be granted power to counter agency delay by imposing deadlines for agency responses to its communications. If an agency missed the deadline, the time for OIRA review would increase accordingly.

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[22] Id. at 3-6.

[23] See Natural Resources Defense Council, Inc. v. Ruckelshaus, 14 ELR 20817 (D.D.C. 1984) (EPA, in violation of statutory deadlines, ordered to issue a rule without OMB review).

Also, OMB could threaten to comment publicly on the rulemaking record in order to induce an agency to respond to its views.

C. Allocating Agency Jurisdiction: Asbestos.

The regulation of asbestos has produced a major controversy over the role and limits of OMB oversight. The dispute concerned OMB pressure on the Environmental Protection Agency to invoke its authority under section 9 of the Toxic Substances Control Act (TSCA)[24] to defer to the Occupational Safety and Health Administration (OSHA) and the Consumer Product Safety Commission (CPSC) for asbestos regulation. Unlike most other instances of OMB oversight, this one involved a question of coordinating action among several agencies having potential jurisdiction.

In 1984, after five years of preparation, EPA sent OIRA two proposed regulations for the control of asbestos.[25] EPA's approach was strict--the rules would have banned four product categories and would have phased down production of others. For about the next six months, EPA and OIRA sparred over the rules. One prominent dispute concerned valuation of benefits. Pursuant to its policy of promoting consistent approaches to cost-benefit analysis, OIRA argued that the health benefits of cancer cases avoided should be discounted for the thirty- to forty-year latency period for asbestos-caused cancer. EPA resisted the discounting approach, noting its consequence of reducing the apparent cost- effectiveness of the rules.

As impasse loomed, OMB began pressing EPA to invoke its § 9 authority, which authorizes it to defer to another agency with jurisdiction over a toxic substance upon a finding that the other agency has power to reduce the risk "to a sufficient extent." EPA had repeatedly rejected the adequacy of such a referral; OIRA now argued that referral was mandatory.

In February, 1985, EPA suddenly announced that it was withdrawing its proposed rules, for referral to OSHA and CPSC. The only support for the decision was an OMB legal memorandum urging that referral was mandatory. After a heated public controversy and hostile congressional hearings, however, EPA reconsidered, and issued proposed rules in January, 1986. Some months later, OSHA issued regulations drastically reducing permissible amounts of asbestos in the workplace.[26]

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[24] 15 U.S.C. § 2608.

[25] The chronology for this account is drawn from EPA's Asbestos Regulations, Hearing Before the Subcomm. on Oversight and Investigations of the House Energy and Commerce Comm., 99th Cong., 1st Sess. (Ser. No. 99-2, 1985), and the Subcommittee's Report, EPA's Asbestos

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[26] NAPA Report at 5.

In the asbestos controversy, an agency reversed a considered position under pressure from OIRA, without any supporting analysis of its own. OIRA swayed EPA's political appointees from a position for which the staff had prepared support that appeared in the administrative record. To be sure, it is the principal officers of an agency who are responsible for its decisions, and a main purpose of executive review is to assure that these officers fully consider administration policy. Still, sudden reversals of policy encounter substantial jeopardy from courts exercising today's "hard look" review for arbitrariness. (An illustration is the ethylene oxide case, described next.)

The notably hostile tone of congressional oversight of this episode may stem partly from a perception that OIRA engaged in some regulatory "forum-shopping," urging EPA to defer only after its intent to pursue stringent regulation became clear. Certainly, OIRA may have acted upon a broader view of the appropriate allocation of jurisdiction to regulate toxic substances. If so, however, the fact that the review process occurs after one agency's rulemaking initiative is well underway can lead to a waste of time and effort. The institution of earlier review of an agency's program pursuant to Executive Order No. 12498 may ameliorate this problem.

D. Constraints of the Administrative Record: Ethylene Oxide.

Ethylene oxide is a suspected carcinogen used in the sterilization of hospital instruments. After the Occupational Safety and Health Administration had considered its regulation for years, a federal court mandated issuance of a rule by June 15, 1984.[27] As the deadline loomed, OSHA completed work on a final rule, in two parts.[28] There was a permanent exposure limit (PEL) of 1 part per million, and a short term exposure limit (STEL) of 10 ppm. OSHA's draft preamble to the final rule explained that studies had shown that the PEL alone would not reduce cancer risks to acceptable levels; instead, it reflected the limits of economic feasibility.[29] OSHA also concluded that its STEL would be economically feasible.

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25 Regulations: Report On A Case Study On OMB Interference in Agency Rulemaking (Comm. Print 99-V, 1985).

[27] Public Citizen Health Research Group v. Auchter, 702 F.2d 1150 (D.C. Cir. 1983).

[28] The chronology for the draft regulations is in Brief of Petitioners, Public Citizen Health Research Group v. Tyson, 796 F.2d 1479 (D.C. Cir. 1986), at 15-24.

[29] This reflected the Supreme Court's holding that "cost-benefit analysis by OSHA is not required by the

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On June 13th, OSHA sent the rule to OMB for review. The next day, OIRA Administrator DeMuth responded with a detailed letter objecting that the STEL was insufficiently supported by the health effects data, and would not be cost-effective.[30] The next day, OSHA forwarded its final rule to the Federal Register. In its haste, OSHA simply deleted the STEL and all reference to it from the final standard, and blacked out the portions of the draft preamble referring to support for the STEL. Conceding that this decision was based "largely in response to reservations expressed by OMB,"[31] OSHA then announced further rulemaking proceedings on the issue of a STEL. These proceedings also terminated without promulgation of a STEL.

In Public Citizen Health Research Group v. Tyson,[32] the Court of Appeals upheld the permanent exposure limit, but remanded the STEL portion of the rule to the agency. Without "any evidence" in the record, the court said, OSHA now argued that the permanent limit would reduce short term exposure. Pointing to studies in the administrative record that suggested the contrary conclusion, the court ordered OSHA to promulgate a STEL or explain more persuasively why it would not. A year later, the court declined to hold OSHA in contempt for further delays, but issued an acerbic opinion characterizing the history of ethylene oxide regulation as one of "hesitation and lack of resolve," and set yet another deadline for final decision.[33] On the last day, March 31, 1988, OSHA issued a STEL regulation.

In the regulation of ethylene oxide, as with asbestos, an agency suddenly changed a considered position in response to OMB pressure. In both cases, the consequent problem was one of bureaucratic regularity--the agency did not take time to conform its administrative record to the altered outcome of the rulemaking. For asbestos, where a pure issue of law was involved, the agency's general counsel would ordinarily provide detailed legal advice supporting referral. Although OIRA's

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[29] [OSH Act] because feasibility analysis is." American Textile Mfrs. Inst. v. Donovan, 452 U.S. 490, 509 (1981).

[30] Letter to Solicitor Francis X. Lilly, Department of Labor, from Administrator Christopher DeMuth, OIRA, June 14, 1984. OIRA also raised questions about OSHA's compliance with Paperwork Reduction Act requirements for clearance of its information collection provisions, and about the rule's restrictions on compliance by other than engineering controls.

[31] 49 Fed. Reg. at 25775 (1984).

[32] 796 F.2d 1479 (D.C. Cir. 1986).

[33] Public Citizen Health Research Group v. Brock, 823 F.2d 626 (D.C. Cir. 1987).

legal position in the asbestos controversy may have been correct, OIRA and OMB do not have the staff resources to do more than raise legal questions that the agencies have neglected. In the ethylene oxide rulemaking, OIRA did just that, asking OSHA how its STEL met the Supreme Court's requirement for a "significant risk" finding.[34]

The importance of trying to ensure bureaucratic regularity is that departures from it produce jeopardy on judicial review. Courts search for signs that issues of fact, policy, and law have been considered carefully. The ethylene oxide case illustrates the potential for sudden policy reverses to fail the requirement of *State Farm* that agencies show they have taken a "hard look" at policy choices. Thus, even if acceptance of OIRA's position improved the agency's action in both cases, the need remained to ensure that the administrative record, including the agency's statement of basis and purpose, fully supported the final outcome. This responsibility lies principally with the agencies, not OIRA. Given the fact that government policymaking frequently occurs under time pressure, however, it is important that both parties to OIRA review recognize the need to protect the administrative record.

E. Factors Made Relevant by Statute.

In *Center for Science in the Public Interest v. Department of the Treasury*,[35] a consumer health group sued the Treasury Department's Bureau of Alcohol, Tobacco, and Firearms (BATF) under the Federal Alcohol Administration Act.[36] for rescinding regulations that were designed to inform consumers, especially those with allergies, of the contents of alcoholic beverages. In 1980, the BATF issued a final rule requiring contents labeling, or in the alternative, notification of the availability of a contents list from the manufacturer. The agency had performed a Regulatory Analysis under the Carter administration's Executive Order No. 12044. The analysis reported wide variations in estimates of both costs and benefits of the rule. In May, 1981, the BATF proposed to rescind the rule, having heeded the call of the new Executive Order No. 12291 to review existing rules under cost-benefit criteria. Finding that the rule's costs were not commensurate with its benefits, the BATF then rescinded the rule.

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[34] Industrial Union Department, AFL-CIO v. American Petroleum Institute, 448 U.S. 601 (1980).

[35] 573 F. Supp. 1168 (1983).

[36] 27 U.S.C. § 201 et seq. Under § 205(e), alcoholic beverages are to be labeled:

> in conformity with such regulations, to be prescribed by the Secretary of the Treasury, . . . (2) as will provide the consumer with adequate information as to the identity and quality of the products, ...

The district court invalidated the BATF's action for two reasons. First, it held that Congress had made an implicit cost-benefit judgment by enacting the statute. The court said that Congress "did not condition [its] grant of authority with a proviso that the regulations could be withdrawn if the costs to the industry turned out to be too high." Second, the court held that the agency had not explained its sudden shift of policy persuasively enough; the action was arbitrary. As in the ethylene oxide case, the administrative record compiled in support of the initial rule had not been refuted.

In striking down the alcohol labeling regulations, the court did not defer to the agency's interpretation of its statutory duties.[37] The later Chevron decision shows that the court's approach, and perhaps its outcome, was wrong. Still, some statutes do preclude a cost-benefit approach. The alcohol labeling act may be one of these.

Even where the text of a statute or its legislative history shows that Congress expects an agency to promulgate regulations addressing a problem, as in alcohol labeling,[38] an agency may enjoy wide discretion in its choice of regulatory strategy. Therefore, OIRA review is most likely to produce a statutory violation by causing an agency to consider a factor that is not relevant under the governing statute.[39] The problem is likely to arise as it did in the alcohol labeling case--a court reads a statute to forbid consideration of a regulation's cost, although that is the focus of the Reagan administration's program. Since OMB requires the performance of cost-benefit analysis even when it may not enter the calculus of statutory decision, the potential for a misstep is especially great.

Controversy of this sort has arisen repeatedly under other health and safety statutes. Administration of the OSH Act, for which the Supreme Court has forbidden a cost-benefit approach, has produced other disagreements as sharp as the one concerning ethylene oxide.[40] The EPA's setting of National Ambient Air

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[37] Indeed, the court heightened the intensity of its scrutiny because the case involved "an action which reverses prior policy [rather than] an action setting policy for the first time." In Motor Vehicle Mfrs. Ass'n

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[38] See 573 F.Supp. at 1170.

[39] This requirement stems from Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971). The Court

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[40] House Comm. on Government Operations, OMB Interference with OSHA Rulemaking, H.R. Rep. No. 98-583, 98th Cong., 1st Sess. (1983).

Quality Standards has led to contention with OMB over the permissibility of considering cost.[41] And the Food and Drug Administration's regulation of color additives under the "Delaney clause," which forbids marketing cancer-causing food additives, has sparked debate over the legality of OMB's suggested "de minimis" exception where cancer risks are low.[42]

Many of these controversies will simmer until the courts either authoritatively construe the governing statutes or defer to executive interpretations under *Chevron*. In the meantime, contentious relations with congressional committees are likely to continue. As long as Congress continues to be organized by the party not holding the White House, the committees are likely to have a different policy orientation from OIRA. In Congress, policy disagreement with an agency is often cast in terms of the agency's violation of its statute. In order to mute the criticisms that are framed in legal terms--and to forestall their possible adoption by reviewing courts--agencies and OIRA should strive to buttress their legal stance more thoroughly than occurred in the asbestos and alcohol labeling cases.

F. OMB's Statutory Power Over Rules: The Paperwork Reduction Act.

Since 1942, the President's budget agency has possessed power to control federal agencies' imposition of paperwork requirements on the public.[43] This function owes its present form to the Paperwork Reduction Act of 1980,[44] which created OIRA. The Act recognizes the implications of granting OIRA power over reporting and recordkeeping requirements that are contained in regulations. Information collection is so

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[37] v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29 (1983), the Supreme Court subsequently held that deregulation does not alter the standard of review.

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[39] extended it to informal rulemaking in *State Farm*, discussed *supra*.

[41] Sen. Comm. Print 99-156, *supra* note V-16 at 36.

[42] House Comm. on Government Operations, HHS' Failure to Enforce the Food, Drug, and Cosmetic Act: The Case of Cancer-Causing Color Additives, H.R. Rep. No. 99-151, 99th Cong., 1st Sess. (1985).

[43] Federal Reports Act, Pub. L. No. 77-831, 56 Stat. 1078.

[44] Pub. L. No. 96-511, 94 Stat. 2812, codified at 44 U.S.C. §§ 3501-20.

central to many federal programs that its control can confer de facto power over regulation itself.[45]

The Act adopts a procedural approach to this problem. Copies of proposed rules that include an information collection requirement must be sent to OMB, which has 60 days to file public comments on whether the requirement is "necessary for the proper performance of the functions of the agency, including whether the information will have practical utility."[46] The agency must respond to OMB's comments when it promulgates its final rule. OMB then has 60 days to disapprove the requirement, on a finding that the agency's response was unreasonable.[47] For executive agencies, OMB's action is final; independent agencies may override it by majority vote.[48]

Within OIRA, administration of the Act is combined with that of Executive Order No. 12291. Desk officers review rules of particular agencies, whether or not they contain a paperwork request, under similar criteria: whether the agency action is justified by its benefits and whether burdens have been minimized.[49] There are some procedural differences between the two kinds of review, however. OIRA maintains public files of paperwork matters, which contain the public's comments on submissions, but perhaps not all correspondence between OMB and the agencies.[50] As with the executive order program, there is much oral communication with the agencies, which is not reflected in the public record.[51] OIRA places an

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[45] 44 U.S.C. § 3518(e) says, however, that nothing in the Act "shall be interpreted as increasing or decreasing the authority of the President [or] the Office of Management and Budget . . .with respect to the substantive policies and programs of . . . agencies." See S. Rep. No. 930, 96th Cong., 2d Sess. 56 (1980).

[46] Id. §§ 3504(h), 3508. OMB has issued new regulations requiring that agency submissions provide more information to the public, such as estimates of the burden imposed by the reporting requirement. See 53 Fed. Reg. 16617 (1988), amending 5 CFR Part 1320.

[47] Id. § 3504(h).

[48] Id. §§ 3504(h)(7), 3507(c). Under § 3504(h)(9), "[t]here shall be no judicial review of any kind of the Director's decision to approve or not to act upon" a requirement.

[49] See Funk, The Paperwork Reduction Act: Paperwork Reduction Meets Administrative Law, 24 Harv. J. Legis. 1, 88-91 (1987). OIRA has developed an Information

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[50] Id. at 92.

[51] Olson, supra note V-18, at 55-59.

explanation for paperwork disapprovals in the public file, along with any separate letter to the agency that states the rationale in greater detail.[52]

In United Steelworkers of America, AFL-CIO-CLC v. Pendergrass,[53] a court of appeals considered the Act's scope. The case concerned OSHA's rule requiring that employers warn workers of potentially hazardous materials in the workplace.[54] OIRA disapproved requirements for exchange at multi-employer worksites of chemical manufacturers' disclosure sheets, and also certain exemptions from duplicative labeling requirements. The court held that the Act's reference to "information collection requests" did not include requirements that industry provide information to the public, as distinguished from requirements that information be furnished to the government.[55] In dicta, the court also stressed the Act's disclaimer of intent to increase OMB's authority over substantive policy decisions delegated to agencies. Although the court's holding provides a relatively clear limit to OIRA authority, its concern over indirect effect on policy suggests that OIRA and the courts may struggle over the relationship between paperwork functions and cost-benefit review.

The executive order processes tend to displace the Act's formal ones, because of timing.[56] Since OIRA reviews rules before they are formally proposed or issued, its negotiation with agencies can and does concern both substantive and paperwork matters, leaving little for the Act's post-notice process. This suggests that the executive order may give OMB as much leverage as it can usefully employ. Neither the working relationships between the agencies and OMB nor the overall rate of rejection of agency proposals seem to differ sharply under the two programs.[57] This is not really

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[49] Collection Review Handbook (Draft ed. Sept. 1988) to guide desk officers in implementing the Act.

[52] See Subcomm. on Oversight and Investigations of House Comm. on Energy and Commerce, 99th Cong., 2d Sess., OMB Review of CDC Research: Impact of the Paperwork Reduction Act 24, 32-37 (Comm. Print 99-MM, 1986).

[53] 855 F.2d 108 (3d Cir. 1988).

[54] Prior stages of the litigation are: United Steelworkers of America, AFL-CIO-CLC v. Auchter, 763 F.2d 728 (3d Cir.

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[55] Thus the court implicitly determined that the Act's ban on judicial review of paperwork approvals does not bar

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[56] Funk, supra note V-49, at 94-95.

[57] Id. at 99-103.

surprising. To the extent that paperwork requirements mirror the rules they enforce, they should evoke the same OMB reactions as do the rules. And the limits of OMB's peremptory behavior may be set more by such bureaucratic imponderables as general relationships with the agency head than by the existence of formal statutory power.

G. Judicial Review of Executive Order Requirements

Executive Order No. 12291 attempts to foreclose judicial review of agency compliance with its requirements. It provides that it "is intended only to improve the internal management of the Federal government, and is not intended to create any right or benefit, substantive or procedural, enforceable at law." In other executive order programs, courts have declined to allow private parties to force agency compliance with presidential mandates. For example, in In re Surface Mining Regulation Litigation,[58] the court considered a challenge to regulations that was based partly on the agency's asserted failure to prepare an inflation impact statement in accordance with Executive Order No. 11281. The court agreed with an earlier decision that the executive order "was intended primarily as a managerial tool for implementing the President's personal economic policies and not as a legal framework enforceable by private civil action."[59] Accordingly, it would not review agency compliance with the order.

The court's approach in Surface Mining was quite conclusory. The reason may have been that it is very unlikely that the President can confer or remove federal court jurisdiction by executive order. Yet it seems appropriate for courts to recognize a President's wishes about the consequences of his own programs, at least as a matter of comity. Here a careful distinction must be made. Of course, courts must inquire whether a regulation is justified on the administrative record. They may consider materials placed in the record pursuant to executive oversight, for example regulatory analyses, as part of the overall question of the validity of the rule. To date, that is what they have done.[60] But it

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[54] 1985); United Steelworkers of America, AFL-CIO-CLC v. Pendergrass, 819 F.2d 1263 (3d Cir. 1987).

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[55] review of disapprovals. See Funk, supra note V-49, at 79-80.

[58] 627 F.2d 1346, 1357 (D.C. Cir. 1980).

[59] 627 F.2d at 1357, quoting Independent Meat Packers Ass'n v. Butz, 526 F.2d 228, 236 (8th Cir. 1975), cert. denied, 424 U.S. 966 (1976).

[60] McGarity, supra note IV-15, at 1318-30.

is quite another thing to consider separately whether the agency has complied with an executive order's requirements, and to reverse its action if it has not.

The burdens of separate litigation over agency compliance with an order would exceed their benefits. Under executive order programs lacking central enforcement provisions (such as Executive Order No. 11821), agency noncompliance was frequent enough to tempt private parties and courts to perform a task that the executive can do for itself. As experience under Executive Order No. 12291 has amply demonstrated, however, OIRA can deal with recalcitrant agencies.[61] The histories of asbestos and ethylene oxide regulation do not portray an executive in need of outside aid.

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[61] For arguments in favor of limited judicial review, see Raven-Hansen, Making Agencies Follow Orders: Judicial Review of Agency Violations of Executive Order 12,291, 1983 Duke L.J. 285; Note, Enforcing Executive Orders: Judicial Review of Agency Action Under the Administrative Procedure Act, 55 G.W. L. Rev. 659 (1987).

VI. *The Openness of OMB Oversight.*

The extent to which OMB oversight of federal rulemaking is openly reflected in an agency's administrative record raises two legal issues. Both are surrounded by uncertainty and debate. First, to what extent are unrecorded "ex parte" contacts permissible in rulemaking? Second, does the President's constitutional executive privilege extend to OIRA's discussions with agencies about their rules? Obviously, these issues are related. They have produced a wealth of analysis, if not agreement. Much of the commentary mixes law and policy, often without clearly distinguishing between them. I will try to identify the law/policy border in the following discussion.

Neither the Administrative Procedure Act (APA)[1] nor the due process clause[2] provides a general bar to ex parte contacts in rulemaking, although some statutes limit them for particular programs.[3] Courts reviewing rules have struggled with two rather inconsistent directives from the Supreme Court, and have consequently produced a confused body of caselaw.[4] *Vermont Yankee* held that agencies may not be required to follow procedures that are not required by statute or by due process.[5] *State Farm* emphasized, however, that the agency's administrative record must provide full substantive justification for its policy choices.[6]

The application of these competing considerations to ex parte contacts within the executive branch was ably analyzed in *Sierra Club v. Costle*:[7]

> The purposes of full-record review which underlie the need for disclosing ex parte conversations in some settings do not require that courts know the details of every White House contact . . . in this informal rulemaking setting. After all, any rule issued here with or without White House assistance must have the requisite *factual support* in the rulemaking record . . . . The courts will monitor all this, but they

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[1] 5 U.S.C. § 551 et seq.

[2] Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519, 542 & n.16 (1978).

[3] *E.g.*, 42 U.S.C. § 7607 (Clean Air Act).

[4] *See generally* G. Robinson, E. Gellhorn & H. Bruff, The Administrative Process 367-84 (3d ed. 1986).

[5] *See* Stewart, *Vermont Yankee and the Evolution of Administrative Procedure*, 91 Harv. L. Rev. 1805 (1978).

[6] Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29 (1983).

[7] 657 F.2d 298, 407-08 (D.C. Cir. 1981).

> need not be omniscient to perform their role effectively. Of course, it is always possible that undisclosed Presidential prodding may direct an outcome that is factually based on the record, but different from the outcome that would have obtained in the absence of Presidential involvement. In such a case, it is true that the political process did affect the outcome in a way the courts could not police. But we do not believe that Congress intended that the courts convert rulemaking into a rarified technocratic process, unaffected by political considerations or the presence of Presidential power.

Reflecting a similar analysis, the Administrative Conference has recommended that rulemakers "should be free to receive written or oral policy advice" from elsewhere in the executive branch, "without having a duty to place these intragovernmental communications in the public file of the rulemaking," unless they contain "material factual information (as distinct from indications of governmental policy)."[8]

A. The Problem of Conduit Communications.

OIRA review can provide a "conduit" by which the views of interested private persons reach an agency, without submission to the publicly available record of a rulemaking. These communications pose two kinds of problems. First, they may include new factual information or policy arguments, which escape the testing process to which other material in the agency's possession is subjected by public comment. Second, due to their endorsement by OMB, they may assume special prominence in the agency's analysis, risking unfairness to those interested persons who do not enjoy the same access. These concerns for the integrity of the administrative record and for fairness to the public sound partly in law and partly in policy. They have resulted in a recommendation by the Administrative Conference that all conduit communications be revealed in the public record of a rulemaking.[9]

Soon after issuance of Executive Order No. 12291, the Department of Justice's Office of Legal Counsel advised OMB regarding ex parte contacts with agencies:[10]

> You and your staff may freely contact agencies regarding the substance of proposed regulations, and may do so by way of telephone calls, meetings, or other forms of communication unavailable to members of the public. . . . [R]ulemaking agencies should disclose in the administrative file . . . substantive

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[8] 1 C.F.R. § 305.80-6.

[9] Id.

[10] Contacts between OMB and Executive Branch Agencies Pursuant to Executive Order 12291 (April 24, 1981).

> communications from your Office to the extent that they are (1) purely factual as opposed to deliberative in nature, or (2) received by your Office from a source outside of Executive or independent agencies. . . . Notwithstanding these general recommendations, we believe that the rulemaking agency need not disclose substantive communications from your Office which form part of the agency's deliberative process.

Thus OLC's advice followed the emerging consensus among administrative lawyers regarding ex parte contacts. OMB adopted it, but not completely. In a memorandum instructing agencies on procedures under the new executive order, OMB stressed that "both the public and the agencies should understand that the primary forum for receiving factual communications concerning proposed rules is the agency."[11] Therefore, factual materials sent to OMB were also to be sent to the agencies for inclusion in the record, and OMB promised to identify as "appropriate for the whole record of the agency rulemaking" any factual material that it developed or received and then transmitted to an agency. Omitted from this formulation was policy material received from outside the government. OMB would soon encounter substantial controversy concerning its use.

A number of health and safety rulemakings during the Reagan administration have produced complaints about conduit communications. Congressional committees overseeing the programs proved sympathetic to these complaints, and brought increasing pressure to bear on OIRA to alter its procedures. Although OIRA has consistently denied that it has served as a conduit, the charges are important because they explain the agreement between OMB and the committees that has opened the review process to greater public scrutiny.

The Environmental Protection Agency was one primary field of controversy. In the asbestos rulemaking, it was charged that there were about twenty communications (letters, meetings, and telephone calls) between OIRA and the asbestos industry and other interested persons.[12] A committee thought that legal and policy arguments that OIRA sent EPA "closely track[ed] arguments made . . . by the Asbestos Information Association in a letter to OMB."[13] OMB denies having had meetings or

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[11] Office of Management and Budget, Memorandum for Heads of Executive Departments and Agencies, Subject: Certain

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[12] EPA's Asbestos Regulations, Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on

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[13] Sen. Comm. on Environment and Public Works, 99th Cong., 2d Sess., Office of Management and Budget Influence on

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telephone conversations with industry representatives, and insists that its positions were developed independently and then were adopted by the industry.[14] There were meetings at OMB, but they were with representatives of the Canadian government and the Interior Department.

In OSHA's ethylene oxide rulemaking, a committee concluded that OMB arguments against the short term exposure limit "apparently repeat[ed] industry arguments which had already been rejected by OSHA."[15] One House report found that OMB met with industry representatives regarding at least two other OSHA rulemakings.[16] A second report found that the Food and Drug Administration's rulemaking on carcinogenic color additives resulted in industry letters to and meetings with OIRA, which then repeated industry arguments to the FDA.[17]

Several features of these cases probably helped to exacerbate relationships with the congressional oversight committees, whose reports developed a notably hostile tone. First, partisan politics undoubtedly played a role, as the administration and the committees squabbled over the direction regulatory policy should take. Second, in rulemaking it is

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11 Communications Pursuant to Executive Order 12291, "Federal Regulation" (June 11, 1981).

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12 Energy and Commerce, 99th Cong., 1st Sess. 231-37 (Ser. No. 99-2, 1985); see also the Subcommittee's Report, EPA's Asbestos Regulations 103 (Comm. Print 99-V, 1985).

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13 Agency Regulations 15, 24-25 (1986). In another rulemaking, on water pollutant guidelines, it seemed to EPA's Chief of Staff that comments from OMB "were of such particularized technical nature . . . in an engineering sense, that they would have had to have come from someone other than the staff of OMB itself." EPA: Investigation of Superfund and Agency Abuses, Hearing Before the Subcomm. on Oversight and Investigations of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. 5 (Ser. No. 98-98, 1983).

[14] OMB posits that the accusations of industry contacts came from the presence in OMB files of papers from the public docket of the agency.

[15] Sen. Comm. Print 99-156, supra note VI-x, at 32.

[16] OMB Interference with OSHA Rulemaking, H. R. Rep. No. 98-583, 98th Cong., 1st Sess. (1983).

[17] HHS' Failure to Enforce the Food, Drug, and Cosmetic Act: The Case of Cancer-Causing Color Additives, H.R. Rep. No. 99- 151, 99th Cong., 1st Sess. 59-62 (1985).

often difficult to separate fact from policy, so that OMB may have seemed to be violating its own rules-- or, indeed, may have done so. Third, the administration's emphasis on regulatory relief opened OMB to portrayal as a special pleader for industry, instead of a critic prepared to see both costs and benefits of regulation.

B. Conflict and Compromise: The Evolution of OMB's Disclosure Policy.

By 1986, OMB was under serious pressure from both houses of Congress. The Chairmen of three important House committees joined in an effort to deny OIRA any appropriations until limits to its powers were enacted.[18] In the Senate, members of the Committee on Governmental Affairs pressed OMB to open its processes.[19] OMB wanted to obtain reauthorization of the Paperwork Reduction Act and to stop the "defunding" move in the House. In June, 1986, OIRA Administrator Gramm issued a memorandum announcing new disclosure procedures.[20] There were two antecedents for them: a Senate amendment to a paperwork reauthorization bill in 1984,[21] which failed to pass, and a special agreement OMB reached with EPA in 1985 for review of its rules.[22]

Under the 1986 procedures, OIRA makes available copies of draft notices of proposed rulemaking and final rules that are submitted for review, along with copies of all related correspondence between OIRA and agency heads.[23] These

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[18] They were Chairman Dingell of the Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, Chairman Brooks of the Government Operations Committee, and Chairman Whitten of the Appropriations Committee.

[19] Senators Durenberger and Levin led the effort. See Oversight of the Office of Management and Budget Regulatory Review and Planning Process, Hearing Before the Subcomm. on Intergovernmental Relations, Sen. Comm.
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[20] Office of Management and Budget, Memorandum for the Heads of Departments and Agencies Subject to Executive Order
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[21] Paperwork Reduction Act Amendments of 1984, S. Rep. No. 98-576, 98th Cong., 2d Sess. 21-23, 35 (1984).

[22] Letter from Robert P. Bedell, Deputy Administrator, OIRA, to A. James Barnes, Deputy Administrator, EPA, May 30, 1985.

[23] Office of Management and Budget, Regulatory Program of the United States Government, 1988-89, App. III. Also
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documents are available once the notices or final rules have been published in the Federal Register. Similarly, OIRA provides on request copies of agency submissions under Executive Order No. 12498, following publication of the final Regulatory Program.

OIRA also agreed to controls on "conduit" communications from persons outside the federal government. Here it referred to its earlier procedures for EPA, along with an offer to extend them to any other agency so requesting.[24] OIRA sends these agencies copies of all written material from outsiders, advises them of all oral communications,[25] and invites agency personnel to attend meetings concerning their rules.[26] It also makes available in its public reading room written materials and lists of meetings and communications involving persons outside the federal government.

These procedures have removed some, but not all, of the controversy over the openness of OMB review.[27] I discuss

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[19] on Governmental Affairs, 99th Cong., 2d Sess. 56-58, 97-98 (1986).

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[20] Nos. 12291 and 12498, Subject: Additional procedures concerning OIRA reviews under Executive Order Nos. 12291 and 12498 (June 13, 1986, revised Aug. 8, 1986).

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[23] available are drafts of advance notices of proposed rulemaking, and lists, at the end of each calendar month, of all notices and final rules for which OMB has completed review.

[24] These agencies now include the Departments of Housing and Urban Development, Labor, Transportation, and the Treasury. Id. at 15.

[25] The practice regarding oral communications is short of logging, in the sense of a summary of the substance of a conversation. Instead, notice is given of the source and subject matter of each conversation.

[26] Since 1981, OIRA has allowed only the Administrator and Deputy Administrator to "meet or talk with members of the public" on matters under the executive orders, unless others are specially authorized. Id. at 15 n. 21.

[27] The 1986 procedures parallel earlier recommendations of the Administrative Law Section of the American Bar Association. See Strauss & Sunstein, The Role of the President and OMB in Informal Rulemaking, 38 Ad. L. Rev. 181 (1986) (urging OMB to make agency submissions and OMB response documents available to relevant congressional committees after the rulemaking activity is complete).

matters concerning Executive Order No. 12498 below. For review under Executive Order No. 12291, the significant gaps in disclosure are: (1) the absence of draft notices and rules that are withdrawn by the agency and never issued; (2) the absence of correspondence between OIRA desk officers and subordinate agency personnel; and (3) the absence of summaries of oral communications between OIRA and the agencies.

C. The Scope of Executive Privilege

Analysis of the appropriate degree of openness of OMB review of rulemaking must consider the role of executive privilege, which may provide a constitutional bar to some measures. Two Supreme Court cases have shed some light on the problem. In United States v. Nixon,[28] the Court recognized a constitutional executive privilege, based on the President's need for confidential policy deliberations. The privilege was qualified, however, and in Nixon itself was overridden by the need of the courts for evidence in a criminal case.

The Court's use of a functional, balancing approach was repeated in Nixon v. Administrator of General Services,[29] in which the Court upheld the power of Congress to regulate presidential papers. From a separation of powers standpoint, the Court said,

> the proper inquiry focuses on the extent to which [the Act] prevents the Executive Branch from accomplishing its constitutionally assigned functions. Only where the potential for disruption is present must we then determine whether that impact is justified by an overriding need to promote objectives within the constitutional authority of Congress.

The Court found that the activities of records archivists would cause only a limited intrusion on confidentiality, and were therefore justified by congressional needs to preserve history. It pointed out that confidentiality is a wasting asset. It is subject to erosion over time by the creation of presidential libraries, the memoirs of participants, and the efforts of historians.[30]

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[28] 418 U.S. 684 (1974); see generally Symposium, United States v. Nixon, 22 U.C.L.A. L. Rev. 76 (1974).

[29] 433 U.S. 425 (1977).

[30] The Court observed, 433 U.S. at 450 n. 12, that most materials in presidential libraries are open, with lessening restrictions over time. The Presidential Records Act, 44 U.S.C. §§ 2201-07, restricts access to the President's deliberations with his advisers for not more than 12 years. The Department of Justice testified

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Congress has been of two minds about executive confidentiality. On the one hand, it has entirely exempted the President and his immediate staff from the Freedom of Information Act,[31] and has provided an exemption from forced disclosure for deliberative materials generated elsewhere in the executive branch.[32] Accordingly, in Wolfe v. Department of Health and Human Services,[33] the court held that FOIA exempts from disclosure material in a "regulations log" that HHS uses to indicate which FDA proposals are being reviewed by HHS or OMB. On the other hand, Congress has repeatedly sought to override claims of executive privilege in order to obtain material in the hands of the executive for its own use.[34] Courts have not announced any clear rules for these congressional-executive contests over information,[35] and it is often difficult to litigate them at all.[36] Consequently, informal negotiation and struggle dominate, with congressional committees obtaining most information they desire if they are persistent enough and enjoy the support of their house of Congress.[37]

Thus, it would not reflect actual government practice to argue that the executive branch possesses a nonwaivable executive privilege for all deliberative material it generates. The executive has sometimes made such claims as a tactic in contests over information, yet it often releases such materials to congressional committees or to members of the public. Indeed, the 1986 compromise between OIRA and its oversight

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30 in support of the constitutionality of the Act. Presidential Records Act of 1978, Hearings on H.R. 10998 and Related Bills Before a Subcomm. of the House Comm. on Government Operations, 95th Cong., 2d Sess. (1978).

[31] Kissinger v. Reporters Committee for Freedom of the Press, 445 U.S. 136 (1980).

[32] NLRB v. Sears, Roebuck & Co., 421 U.S. 132 (1975).

[33] 839 F.2d 768 (D.C. Cir. 1988) (en banc).

[34] See generally Shane, Legal Disagreement and Negotiation in a Government of Laws: The Case of Executive Privilege Claims Against Congress, 71 Minn. L. Rev. 461 (1987); Cox, Executive Privilege, 122 U. Pa. L. Rev. 1383 (1974).

[35] United States v. AT & T Co., 567 F.2d 121 (D.C. Cir. 1977).

[36] See, e.g., United States v. House of Representatives, 556 F.Supp. 150 (D.D.C. 1983).

[37] See P. Shane & H. Bruff, The Law of Presidential Power 187-208 (1988), for case studies that support this proposition.

committees is one example of the contingent nature of executive confidentiality as it actually operates.

The executive branch has, however, two strong claims for confidentiality. First, deliberations between the President and his immediate advisers (which were involved in Nixon itself) implicate the President's ability to perform his constitutional functions, and deserve a strong presumption of confidentiality. Thus, if the President or his immediate advisers wish to discuss regulatory policy with an agency head, their conversations need not reach the administrative record.[38] This does not necessarily mean, however, that communications between OIRA and agencies deserve the same treatment, as I discuss below.

Second, throughout the executive branch there is an essentially unvarying interest in protecting policy discussion while a decision is under consideration, as opposed to after the fact. This is not a matter of encouraging candid advice, which needs long-term protection to flourish. Instead, it is a matter of power over the policy decision itself. When deliberation on a pending decision is open, it is very hard to limit the lobbying of every interested person and to control the situation. With these considerations in mind, let us turn to specifics on the openness of OMB oversight.

D. Protecting the Administrative Record: A Paper Trail Or A Logging Requirement?

Regulatory oversight has evolved during the Reagan Administration. The NAPA study concluded that "while it appeared originally to respond to the demands of regulated industries for regulatory relief and to operate with little public and congressional scrutiny, it is now more open and restrained."[39] NAPA called for even more openness, recommending that agencies "log, summarize, and include in the rulemaking record all communications from outside parties, OMB, or other executive or legislative branch officials concerning the merits of proposed regulations."[40]

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[38] Sierra Club v. Costle, 657 F.2d 298 (D.C. Cir. 1981).

[39] NAPA Report at 7.

[40] Id. at 35. NAPA explained:

> Just as agency decisionmaking can be improved by subjecting it to external scrutiny, so can OMB's analyses of agency proposals benefit from outside review. The same arguments used to justify OMB review itself--that agencies need to articulate formally what they are doing and why their actions are appropriate -- apply equally to OMB.

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NAPA's approach is not the only acceptable one.[41] Any particular disclosure feature should be judged by its marginal contribution to the values served by openness, weighed against its marginal burdens and interference with the values served by confidentiality. Let us proceed by analyzing increasing levels of disclosure.

The 1986 compromise between OMB and the committees produces a "paper trail" of oversight activity. Those interested can track the written portions of OMB's activity, to check its wisdom and legality. Knowing that this trail is being left, those within OIRA and the agencies can be expected to ensure that their interchange is within legal limits. Presumably, however, candor suffers somewhat. The effects are both good and bad. Pressure to ignore the administrative record or statutory limits may be less likely to occur when it must be delivered orally, and to that extent furtively. On the other hand, written advice may be crafted for the public eye, with more posturing and less incisiveness.

Less than this amount of disclosure does not seem desirable. In the early years of the Reagan administration's program, charges frequently arose that OMB was pressing an agency beyond the parameters justified by its statute or its administrative record. Under the pressure of congressional investigation, a paper trail of each controversial rulemaking emerged to allow resolution of the dispute. This pattern is likely to occur again in the future, with its heavy transaction costs for all concerned, unless, a paper trail is routinely provided. Similarly, the new controls on conduit communications seem necessary to ensure the fairness of executive oversight.

The 1986 compromise does not, however, produce a complete paper trail. One omitted category is notices and rules that are withdrawn by an agency. Adding these items would not pose much added burden for the agencies and OMB. Indeed, the availability of submissions for the regulatory program pursuant to Executive Order No. 12498, whether or not the initiative matures in a notice of proposed rulemaking, shows that such an addition would be feasible.

The 1986 compromise also does not reveal correspondence among subordinate personnel, for example memos exchanged by

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[40] In his separate views, id. at 44, Richard Wegman called for placing any centralized control early in the rulemaking process. If it occurs during the comment period or before, he argued, the public can react to it. He would avoid all post- comment period involvement as too productive of "political mischief".

[41] For a similar approach, see S. 2023, 99th Cong., 2d Sess. (1986).

desk officers and agency staff, although congressional inquiries or leaks often reveal them. The routine availability of these items would materially aid understanding of the oversight process, only a portion of which appears in formal written communications between the Administrator of OIRA and agency heads. Also, pressure to ignore an agency's statute or administrative record can occur at any level of the process. On the other hand, revealing staff dialogue might blur political accountability within both OIRA and the agencies by inviting observers to wonder who speaks for the institution, the staff or the political appointee at the top. Knowing their correspondence would be made public, staff could try to tie the hands of their superiors by taking strong positions in print. On balance, I think this material should be available, although the issue is close.

Another possible modification of the 1986 procedures would be to require agency drafts to be published in the Federal Register simultaneously with their submission to OMB. I think it better to make the drafts available only after the rulemaking notices have been published. Publicity about the pendency of review can only increase pressure on OIRA to engage in communications with interested persons. Instead, rulemaking procedure should be structured to guide persons outside the government to the agency, not to OIRA.

Whether oral communications should be "logged" (summarized and placed in the public record) presents another close question.[42] Longstanding dispute over this procedure has made the arguments familiar. The traditional conception of rulemaking as an informal, "quasi-legislative" activity has made unrecorded ex parte contacts seem permissible. Congress has declined to amend the APA to alter that view.[43]

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[42] See generally Gellhorn & Robinson, Rulemaking "Due Process: An Inconclusive Dialogue, 48 U. Chi. L. Rev. 201 (1981); Verkuil, Jawboning Administrative Agencies: Ex Parte Contacts by the White House, 80 Colum. L. Rev. 943 (1980).

[43] Action for Children's Television v. FCC, 564 F.2d 458, 474-75 n.28 (D.C. Cir. 1977):

> If Congress wanted to forbid or limit ex parte contact in every case of informal rulemaking, it certainly had a perfect opportunity of doing so when it enacted the Government in the Sunshine Act, Pub. L. No. 94-409, 90 Stat. 1241 . . . . That it did not extend the ex parte contact provisions of the amended section 557 [which governs adjudication] to section 553 [which governs rulemaking]--even though such an extension was urged upon it during the hearing--is a sound indication that Congress still does not favor a per se prohibition or

(Continued on next page)

Moreover, an agency must defend its rules in court solely on the basis of the public record, and may not rely on facts or policy argument not reflected there.

The NAPA study finds these considerations outweighed by improvements that disclosure will bring to the oversight dialogue. Certainly, OMB pressure to ignore the administrative record or the statute can be applied as easily by voice as by pen. Yet that pressure can occur anyway, at higher levels of the executive branch, in ways that are difficult or impossible to police. And for detailed policy argument, there may be no practical alternative to writing. A strict logging requirement in OIRA could simply shift oral discussion up the organization chart, or into the early rulemaking stages to which logging requirements generally do not apply.

Logging all oral communications would add a significant burden to administration. More important, it would alter the relationship between OMB and the agencies in some undesirable ways. The very presence of an executive privilege concept recognizes a positive value in informal discussion. Policy debate tends to feature negotiation and compromise, as the history of OMB oversight illustrates. Negotiation is not a flower that blooms in sunlight. Therefore, there is reason to maintain an informal, oral channel of communication between agencies and OIRA, even if more detailed, formal communication that is written down if available to the public.

The Administrative Conference has recommended against requirements that agencies place written or oral policy advice from OMB in the administrative record.[44] The Conference thought, however, that material factual information and all conduit communications coming from OMB should appear in the record. This seems the correct approach, except for the "paper trail" procedures that I have recommended above. At least for the present, a universal logging requirement seems premature.[45]

E. Executive Order No. 12498 and the Planning Process.

At the start of its second term, the Reagan administration reached earlier into the rulemaking process with Executive Order No. 12498. The order requires the head of each executive agency to send OMB a "draft regulatory program" that describes "all significant regulatory actions" to be undertaken within

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(Continued from previous page)

[43] even a "logging" requirement in all such proceedings.

[44] 1 C.F.R. § 305.80-6.

[45] My views were once to the contrary; *see* Bruff, *Presidential Power and Administrative Rulemaking*, 88 Yale L.J. 451, 504-06 (1979).

the next year. OMB reviews the plan for consistency with administration policy, and a final Regulatory Program is published.[46] As I noted above, the order's purpose is to give political appointees in OMB and the agencies more control of the early stages of rulemaking.[47]

OMB's definition of the significant regulatory actions to which the order applies is broad. It includes the creation of an agency task force to evaluate the need for a regulation, the undertaking of studies of economic problems, and analysis of health and safety risks that might lead to regulation.[48] Consequently, immediate criticism arose that the order would stifle investigative activity that would have shown the need for regulation.[49]

OMB's 1986 disclosure policy included a promise to make available all agency drafts submitted to OMB under the order, after publication of the year's Regulatory Program. Without the availability of the drafts, public and congressional monitoring of OMB's activity would have been extremely difficult. This aspect of the disclosure policy should be continued. Correspondence between OMB and the agencies, or from persons outside the government, should also be made available. But oral communications between OMB and the agencies should remain confidential, as they traditionally have been at these early stages of the rulemaking process.

The purpose of partial disclosure under this executive order differs somewhat, however, from that for Executive Order No. 12291. Oversight occurring very early in the rulemaking process is not likely to pose an identifiable threat of a statutory violation, unless a statute unequivocally calls for regulation. Nor is it likely to undermine a developed administrative record. Instead, the purpose is more political, to reveal the road not taken. Then the interested public and congressional committees can decide whether to press for a different course.

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[46] See generally Note, Presidential Policy Management of Agency Rules Under Reagan Order 12,498, 38 Ad. L. Rev. 63 (1986).

[47] See Part III, text at notes 16-17 supra; see also DeMuth & Ginsburg, White House Review of Agency Rulemaking, 99 Harv. L. Rev. 1075, 1085 (1986).

[48] OMB Bulletin 85-9 & Attachment 1 (1985).

[49] Sen. Comm. on Environment and Public Works, Office of Management and Budget Influence on Agency Regulations, 99th Cong., 2d Sess. 10-12 (Comm. Print 99-156, 1986); Morrison, OMB Interference with Agency Rulemaking: The Wrong Way to Write a Regulation, 99 Harv. L. Rev. 1059, 1063 (1986).

VII. Defining Exceptions to OMB Oversight

A. Independent Agencies and Excepted Functions.

To date, Presidents have not attempted to apply their regulatory management executive orders to the independent agencies. Although President Reagan was advised that he had the constitutional power to include these agencies in the coverage of Executive Order No. 12291, he chose not to do so.[1] The extent of a President's constitutional power over an agency that Congress has chosen to shield from his supervision has been a matter of spirited, if inconclusive, debate for many years.[2]

The Supreme Court's latest foray into the field has given the debate new life. Morrison v. Olson[3] announced a new test for the constitutionality of restrictions on the President's power to remove executive officers: whether the statutes "impede the President's ability to perform his constitutional duty." This test is surely better than the old one (whether an office is "purely executive") with its invitation to bright lines where the reality of government offers none. Nevertheless, it states but does not answer the central question--what is the nature of the President's constitutional duty?[4] A narrow definition might include only the substantive grants of power over foreign affairs and national defense in Article II, and would therefore confer little supervisory power over rulemaking. A broad definition might emphasize the President's duty to take care that the laws be faithfully executed, and would envision broad supervisory power.

Some guidance emerges from the Court's holding in Morrison, and from a distinction it made. The Court upheld independence where conflicts of interest undermine normal political accountability, the investigation and prosecution of high-level crime in the executive branch.[5] Ordinary regulation does not pose this problem. Thus the Court cautioned that special prosecutors do not enjoy "policymaking or significant administrative authority." This statement implies a broad view of presidential power--that placing policymaking responsibilities in independent agencies infringes the President's powers by undermining political accountability. Of course, the Court left that question for another day.

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[1] Office of Legal Counsel, Department of Justice, Memorandum for Honorable David Stockman, Director, Office of Management and Budget, Re: Proposed Executive Order on Federal Regulation (Feb. 12, 1981).

[2] See generally Symposium, The Uneasy Constitutional Status of the Administrative Agencies, 36 Am U. L. Rev. 277 (1987); Miller, Independent Agencies, 1986 Sup. Ct. Rev. 41.

[3] 108 S.Ct. 2597 (1988).

[4] For a summary of the debate over the nature of his powers, see text at notes I-6 to I-13 supra.

[5] See Bruff, supra note I-27.

Any functional, balancing doctrine is uncertain in application. Nevertheless, the President has a substantial argument that his need to supervise most regulation of the traditional independent agencies is no less than for the executive agencies. Much of the policymaking of the independent agencies is not functionally distinct from that of executive branch agencies. For example, the Federal Trade Commission shares antitrust enforcement responsibility with the Department of Justice. Thus, policies adopted by independent agencies can affect those of executive agencies.[6] Moreover, congressional difficulties with policy coordination pertain to all agencies.

Some independent agencies make policy that is vitally important to our national life, so that presidential interest in its formulation is both inevitable and proper. The Federal Reserve Board's monetary functions and the Securities and Exchange Commission's market regulation come to mind. Nevertheless, congressional perception of a need to insulate particular kinds of regulation from presidential supervision is entitled to some judicial deference. How are we to resolve these imponderables? Happily, the Court appears to be moving away from loose conceptions that whole agencies have a special constitutional status outside the executive branch, and toward a more focused inquiry whether the President has been denied a supervisory role that is appropriate to the particular function involved.[7] That appears to be implicit in Morrison's willingness to allow some prosecutorial functions to be made independent, without adopting the position that the entire Department of Justice could be so insulated.

Therefore, we need to identify kinds of rulemaking programs for which presidential supervision is not appropriate. The principal inquiry should be whether the executive's accountability cannot be trusted. Thus, some federal rulemaking should be excepted from executive oversight because the President's role as head of his party may give him a personal interest in the subject matter. Two prominent examples are administration of the Federal Communications Commission's "equal time" rules[8] and the Federal Election Commission's regulation of political campaigns.

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[6] See Westinghouse Electric Corp. v. Nuclear Regulatory Commission, 598 F.2d 759 (3d Cir. 1979) (NRC could suspend recycling of nuclear fuel in deference to presidential request based on efforts to prevent international proliferation of nuclear weapons).

[7] See P. Shane & H. Bruff, The Law of Presidential Power 326 (1988).

A second inquiry is whether political accountability would interfere with successful performance of the function. Thus, the Court might conclude that sound monetary policymaking requires the insulation from normal accountability to both President and Congress that the Fed now enjoys, because short-run political considerations would hamper this function.

Some kinds of rulemaking functions should receive categorical exemption from presidential supervision. Executive Order No. 12291 does not apply to "formal" rulemaking, which is performed according to the APA's procedures for adjudication.[9] This exception recognizes that the distinction between rulemaking and adjudication is sometimes blurred. Due process strictures apply when some individuals are "'exceptionally affected, in each case upon individual grounds,'" by administrative action.[10] Adjudication has traditionally been protected from outside interference by anyone.[11] These due process values lurk in the cases upholding agency independence from presidential supervision, because adjudicating agencies were involved.[12]

When rulemaking resembles adjudication by deciding "conflicting private claims to a valuable privilege," courts have barred ex parte contacts.[13] For this reason, ratemaking should be excepted from executive oversight.[14] This would also respect the congressional judgment that ratemaking should ordinarily be insulated from politics.[15]

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[8] 47 U.S.C. § 315.

[9] The order's § 1(a)(1) exempts actions 'governed by the provisions of Sections 556 and 557 of Title 5 of the United States Code."

[10] United States v. Florida East Coast R. Co., 410 U.S. 224, 242-45 (1973), quoting Bi-Metallic Investment Co. v. State Board of Equalization, 239 U.S. 441, 446 (1915).

[11] The APA, 5 U.S.C. § 557(d), bars all ex parte contacts in adjudication and formal rulemaking.

[12] See, e.g., Wiener v. United States, 357 U.S. 349 (1958) (War Claims Commission).

In a number of modern statutes, Congress has created rulemaking programs that are "hybrids" because they employ some adjudicative procedure.[16] This implies that ex parte contacts are inappropriate, but does not necessarily compel that conclusion. A statute-by- statute judgment is necessary. For example, a statute may have addressed executive branch contacts explicitly, partially controlling them.[17] If not, it is necessary to assess the appropriateness of oversight for the substantive issues involved in the program.

B. The Desirability of Statutory Controls on Oversight

Should a statute be enacted to ratify and control presidential management of regulation? There has been sufficient experience under the executive orders to justify statutory codification. Moreover, there is reason to believe that enactment is feasible, because there are advantages for both the President and Congress. The President could gain by resolving lingering doubts about the program's legitimacy, and perhaps by obtaining its extension to the independent agencies.

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[13] Sangamon Valley Television Corp. v. United States, 269 F.2d 221, 224 (D.C. Cir. 1959) (FCC allocation of television channels to particular communities).

[14] ABA Commission on Law & the Economy, Federal Regulation: Roads to Reform 82 (1979) (exempting ratemaking from a general call for presidential supervision of rulemaking, because "although technically rulemaking under the Administrative Procedure Act, [it involves] quasi-judicial functions that should be kept separate from the political process."). See also United States v. Florida East Coast R. Co., 410 U.S. 224, 251-54 (1973) (Douglas & Stewart, JJ., dissenting).

[15] See Sen. Comm. on Governmental Affairs, Regulatory Organization, 5 Study on Federal Regulation, 95th Cong., 1st Sess., 67-81 (1977) (so explaining the creation of the Federal Energy Regulatory Commission as an independent agency within a cabinet department).

[16] E.g., 15 U.S.C. § 57a (Federal Trade Commission).

[17] See 42 U.S.C. § 7607(d) (Clean Air Act).

Congress could gain by codifying disclosure practices that aid its capacity to oversee the program. Note that existing doubts about legality foster compromise in the legislative process -- if the Court removes them with a broad endorsement of presidential power, the executive may resist statutory control of the program.

Also, doubts about legality affect the present nature of the program. The behavior of the participants can be expected to change somewhat under a statutory regime. At present, OMB-agency relationships usually feature negotiation. As experience in separation of powers controversies teaches, that is what we should expect in conditions of uncertainty about ultimate power.[18] If the uncertainty is removed, behavior should change somewhat. Statutory ratification of the program could produce a more peremptory approach by OMB. It is not clear, however, that the change would be very great. For example, OMB's behavior under the Paperwork Reduction Act does not seem sharply different from that under the executive orders. As all students of bureaucracy know, many variables affect OMB-agency relationships, for example the nature of the personal relationship between an agency head and the President.

The informal agreement that OMB reached with its congressional oversight committees in 1986 did not establish a long-term resolution of the issues that had arisen in the Reagan administration.[19] A management program in the next

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[18] Executive privilege controversies between President and Congress provide a prominent example. See P. Shane & H. Bruff, supra note VII-7, at 184-208 (1988).

[19] The denouement of the effort to "defund" OIRA occurred when Senate and House conferees agreed to reauthorize the Paperwork Reduction Act, as part of the continuing resolution passed in October 1986. Cong. Rec. H 10699 (Oct. 15, 1986). The compromise provided for: (1) a separate line item account for OIRA in OMB's budget with authorized spending of $5.5 million for the next three years; (2) Senate confirmation of the administrator of OIRA; and (3) a prohibition on the use of the funds authorized for "any function or activity which is not specifically authorized or required by this [Act] . . . . The review of a rule or regulation is specifically authorized or required by this [Act] only to the extent that such review is for the sole purpose of reviewing an information collection request contained in, or derived from, such rule or regulation." The sponsors of the reauthorization compromise explained that OIRA could

(Continued on next page)

administration will probably encounter strong pressure to reach a similar modus vivendi with the committees. In that case, the primary advantages of a statute would be to give Congress an opportunity to decide which rulemaking programs should be exempt from review, and to enact more permanent controls.

Congress has begun to consider bills that would forbid or limit OMB review of particular programs.[20] In the absence of a generally applicable statute, the executive might simply apply its program to the independent agencies, letting the courts struggle with Morrison's criteria to define the limits of executive management. Instead, the better course would be to put OMB review on a statutory basis, with controls reflecting experience to date.

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[19] (Continued from previous page) perform other functions if it obtained separate funding for them. 132 Cong. Rec. H 10896 (Oct.15, 1986). The appropriations act then provided $5.5 for OIRA with no restrictive language, except to continue the prohibition against OMB review of agricultural marketing orders. 132 Cong. Rec. H 10693 (Oct. 15, 1986).

[20] E.g., S. 2443, 100th Cong., 2d Sess. (1988) (Nuclear Regulatory Commission).

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-10

ELECTRONIC ACQUISITION AND RELEASE OF FEDERAL AGENCY INFORMATION

by

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October 1, 1988

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VII.RECOMMENDATIONS

- A. Freedom of Information Act
  - 1. Agencies should interpret the Freedom of Information Act to cover electronic information.
  - 2. Agencies should not frustrate the purposes of the FOIA by replacing systems of paper records with electronic databases, and then denying access to the electronic data on

the grounds that the electronic form of pre-existing paper records data is not

3. Differences in agency technologies and database structures make it necessary, for the near term, to define FOIA obligations on a case-by-case basis. Specific controversies under the Act, over how requesters must define records, how much programmi

B. Acquisition of Information in Electronic Form

1. Agencies should acquire information in electronic form when agencies use the information in electronic form and when most information submitters already maintain information electronically, or have ready access to intermediaries who will prepare

2. Agencies incur significant costs when they acquire information in paper form and convert it into electronic form. Private sector entities providing information to the government also incur costs when they must convert electronic information kept in

3. Agencies initiating electronic acquisition programs should

explore technologies to facilitate electronic filing by small or unsophisticated entities, including the use of "smart forms." When a significant proportion of the filer community is techn

C. Release of Information in Electronic Form

Agencies maintaining information in electronic form should release information electronically at one or more of three levels, based on statutory mandates to release information, present practices with respect to paper forms of the information, and the

1. When publishing is mandated by statute or when paper publishing exists, agencies should promote electronic publishing of the information unless the cost/benefit analysis suggests offering a lower level of electronic release.

2. When a statute mandates public reference room disclosure, or paper products presently are made available through a public reference room, agencies should provide electronic disclosure in public reference rooms, and should release information e

3. In other instances, agencies

maintaining information in electronic form should provide for access to such information in electronic form in response to FOIA requests, and consider the costs and benefits of upgrading release of appropriate part

D. Roles of Public and Private Sectors

2. Agencies should presume that private sector electronic information products will continue to be provided by private sector sources, and should consult with the private sector providers to explore enhancements or pricing changes that appear desirable

3. If new electronic means of agency acquisition or new information products are warranted by agency missions and the private sector is unwilling to make a commitment to provide them at appropriate prices, agencies should provide them, if clearly ide

E. Determination of Costs and Benefits in Evaluating Available Electronic Information Products

1. Agencies should take into account the following costs in decisionmaking processes suggested in Recommendations B, C and D:

2. Agencies should take into account the following types of benefits in decisionmaking processes suggested in Recommendations B, C and D:

3. Cost-benefit analyses should take into account FOIA obligations. In designing electronic databases, agencies should consider explicitly the types of FOIA requests likely to be received for data in the database. Insofar as it is consistent with agenc

4. In some cases, effective design, motivated by responsiveness to agency missions, or by making information effectively available electronically to a wider spectrum of the citizenry, will require some sacrifices in FOIA retrieval capability. In th

5. In other cases, new electronic information products may reduce costs, to both requesters and agencies, of FOIA requests. This would occur, for example if certain information were published electronically or disclosed electronically in a public re

F. Monopoly Over Public Information

No federal agency should grant

monopoly power to a private firm over public information in possession of the agency.

G. Format of Information

1. Agency electronic acquisition and release systems should incorporate state-of-the-art technology as to security, format standards, and telecommunications techniques.
2. Agency electronic acquisition systems should include appropriate access control and other techniques to minimize security problems.
3. Agencies should seek to develop electronic information formats through existing standards efforts such as ANSI X.12 (EDI) before embarking on sui generis format definitions.
4. Agencies should use Public Data Networks whenever possible rather than developing their own communications links for public filers or consumers. Telecommunications systems adequate for wide public dissemination rarely are a byproduct of agency autom

H. Administrative Procedure Act Proceedings

Agencies should experiment with

electronic means of providing public participation in rulemaking and adjudication under sections 553, 554, 556 and 557 of the Administrative Procedure Act, making suitable provisions for those wishing to participate bu

I. Government-wide Electronic Information Policy

1. A government-wide electronic information policy is desirable to afford guidance to agencies. Such a policy should articulate goals consistent with those expressed in Recommendations A to H.

2. OMB should develop guidelines for agency electronic acquisition programs as well as for electronic release. These guidelines should address with particularity cost-benefit and funding problems and offer guidance on how consultation between agen

3. The most appropriate role for the Congress is to make the larger value judgments involved in formulating government-wide policy. The Congress should decide the degree to which, and the circumstances under which, the government should hold

back i

4. Instead of micromanaging agency electronic acquisition and release programs, the Congress should exercise oversight of agency compliance with generic policy guidelines, including scrutiny of agency classification of information types as suggested in

J. National Institute of Standards and Technology

The National Institute of Standards and Technology should continue to work with USPTO to advance optical disk storage technology, and should continue and intensity its effort to inform agencies about commercially available products and services to fac

K. Administrative Conference of the United States

1. The Administrative Conference should continue to facilitate government-wide consideration of appropriate electronic information policy and technology alternatives.

2. The Administrative Conference should develop resource materials for agencies to use in evaluating Artificial In-

telligence techniques for incorporation in agency information management systems.

3. The Administrative Conference should continue to monitor major agency electronic acquisition and dissemination systems and prepare updates from time to time on the issues identified in this report.

EXECUTIVE SUMMARY

Computer technologies, and the widespread use of affordable computers make it possible for federal agencies to acquire and release information electronically. Persons desiring or required to file information with agencies can do so by computer instead of filing paper submissions. Once agencies possess information in computer form, they can make it available via computer instead of only on paper.

Agency Activities

More than a score of federal agencies actually are engaged in, or are contemplating, significant electronic acquisition and release programs. The following chart summarizes the major agency programs reviewed in this report.

Agency	Acquisition			Release			
	MAND	INTER	PAGE	ACCESS	DISCL	DISSEM	PRIVATE
SEC	√			√			√
IRS		√					
USCS		√			√		√
FERC	√					√	
FMC	√					√	
USPTO			√	√			
Off. Federal Register/GPO				√			
Depository Libraries					√		
DOT		√			√		
ICC					√	√	
NRC √		√		√			
Department of Energy							
NLM					√		
USDA					√	√	
Department of Commerce						√	
FDA	√						
National Weather Service						√	√
National Inst. of Stds & Tech.						√	
EPA/OSHA Emergency Response						√	
Census Bureau						√	
Supreme Court					?	?	√
Lower Federal Courts							√

The chart shows the agencies on the left. A check in the column headed "MAND" indicates that electronic filing is mandatory. A check in the column headed "INTER" means that the acquisition program relies heavily on intermediaries. A check in the column headed "PAGE" means that page image data is accepted. A check in the column headed "ACCESS" means that electronic release is limited to access. A check in the column headed "DISCL" means that electronic disclosure is used. A check in the column headed "DISSEM" means that electronic dissemination is used. A check in the column headed "PRIVATE" means that the electronic release activities are designed to rely heavily on private sector resellers.

The paradigmatic electronic acquisition systems are SEC's EDGAR, permitting corporations to send electronic securities filings to the SEC, and the IRS Electronic Filing Program, permitting third-party tax preparers to file tax returns with the IRS electronically.

The paradigmatic electronic dissemination program is the Department of Commerce electronic bulletin board, which permits anyone with a desktop computer and modem to dial a telephone number and receive economic statistical information by selecting choices from a menu.

The paradigmatic electronic disclosure program is SEC's EDGAR, which permits retrieval of EDGAR filings from terminals in SEC public reference rooms.

The paradigmatic electronic access program is GPO release of typesetting files for the Federal Register on magnetic tape.

Policy and Legal Issues

Electronic acquisition of information is relatively non-controversial. In many cases, the initiative for electronic acquisition has come from filers. Agencies sponsoring electronic acquisition programs generally have consulted with affected interests regarding format standards, use of intermediaries to prepare electronic submissions and whether programs should be voluntary or mandatory.

Electronic release initiatives are much more controversial. A recurring controversy in such programs is whether agencies should retail computerized information—make it easily available to the general public—or whether they should limit their roles to wholesaling—releasing information only in bulk for possible retailing by private enterprise. At present, administrative agency dissemination policies are being driven toward wholesaling and away from retailing by the desire of private sector information providers to protect markets, combined with congressional desire for control over the purse strings. Present policy seeks to mobilize market forces to ensure availability of information at a price no greater than distribution costs. Agencies should not, according to these concepts, frustrate market forces by protecting markets for information to create a monopoly for their own automated system, or to protect markets for contractor systems. Nor should agencies discourage market entry by "dumping" information products at prices lower than those necessary to encourage private capital investment.

This report discusses the following issues, and offers recommendations:

1. How should electronic information be handled under the Freedom of Information Act?
2. How should agencies decide what electronic acquisition activities are appropriate? Can private sector electronic intermediaries ease the burden of mandatory electronic filing?
3. How should agencies decide what levels of electronic release are appropriate?
4. How should agencies define appropriate public and private sector roles? Do the microeconomics of electronic information dissemination permit market-based private sector policies to be realized?
5. Should the Congress manage electronic filing and dissemination systems in detail?

The report's recommendations are intended to guide agencies that keep and use information in electronic form, when electronic acquisition and/or release of the information from or to the public is necessary to the agency's mission, or is required by the Freedom of Information Act ("FOIA"). Policy judgments about electronic acquisition and release systems, like other policy judgments, have a political dimension. Despite the focus of the this report on technology and cost/benefit factors, decisionmakers must not forget the aphorism that politics is the art of the possible and the science of timing. There is no point in making exactly the "correct" choice according to objective factors but be denied funding or have the Congress amend authorizing legislation to dictate the terms of an electronic system. Agency decisionmakers should define affected parties and consider how their interests can be satisfied.

Information long has been recognized as playing an essential role in a democratic political system. The rapidly advancing revolution in information technology raises anew many economic and policy issues addressed by agencies, Congress and the courts with respect to information in general. The technology makes it possible for agencies to acquire information electronically or to release information electronically. Electronic acquisition can occur by submission of magnetic tape, cassettes, disks, optical disks, or transmission over telephone links. Information can be released electronically via the same media, and by satellite transmission.

The new information technologies can improve public access to public information, and reduce paperwork burdens, but they also can impose significant economic burdens and threaten the position of established electronic information enterprises.

The policy and legal issues differ somewhat depending on whether one considers electronic acquisition by agencies or electronic release by agencies. The policy and legal issues pertaining to electronic release differ considerably depending on whether one considers access obligations under the FOIA in response to discrete requests, or whether one considers more active agency initiatives to disseminate information through some form of electronic publishing.

In this stage in the evolution of government electronic information policy, the most one can do is to suggest substantive principles to be applied in the first instance by agency electronic system designers, policy makers, and budget planners. The objective is to provide an analytical framework within which agencies can think about options, and justify choices made, by articulating their rationale according to the framework. Ultimately, of course, responsibility for policing compliance with the framework or for deciding whether the framework is appropriate rests with the courts interpreting existing statutory authority and obligations, and with the Congress in reshaping agency duties. As experience is gained, the Congress ought to set policy on as broad a basis as possible. It ought not to specify the details of particular acquisition or release programs.

As with any important societal change, the revolution in information technology occurs at a different pace in different sectors of the society. It is inevitable that some private filers of information with the government will sometimes have technology that exceeds the government's ability to accept the information in the form in which it is kept and most easily filed. In other cases, the reverse will be true. In many cases, the government will be ready to provide, and will prefer to provide for economic reasons, information in electronic form to persons who are not ready to consume it in electronic form. It will be a long time before every citizen has a microcomputer and a modem. Until such time as most citizens and government agencies have roughly equivalent technologies, transitional arrangements will be necessary to ensure that electronic acquisition and release do not prejudice major segments of the population.

Text of Recommendations

A. Freedom of Information Act

1. Agencies should interpret the Freedom of Information Act to cover electronic information.

2. Agencies should not frustrate the purposes of the FOIA by replacing systems of paper records with electronic databases, and then denying access to the electronic data on the grounds that the electronic form of pre-existing paper records data is not a "record," that retrieval of the electronic information is equivalent to creation of a "new" record, or that programming is required for retrieval. On the other hand, agencies should not be obligated under the FOIA to create large new databases for economic exploitation, in effect paying capital costs for private ventures.

3. Differences in agency technologies and database structures make it necessary, for the near term, to define FOIA obligations on a case-by-case basis. Specific controversies under the Act, over how requesters must define records, how much programming an agency must do, if any, and how costs shall be borne, cannot be resolved soundly until agencies and requesters gain further experience with electronic information. The concepts of reasonableness applied to FOIA requests and searches for paper information is a useful guideline for resolving electronic FOIA controversies.

B. Acquisition of Information in Electronic Form

1. Agencies should acquire information in electronic form when agencies use the information in electronic form and when most information submitters already maintain information electronically, or have ready access to intermediaries who will prepare and submit it in electronic form. When agencies sponsor electronic acquisition programs, they should ensure that all information of the same type eventually is available to them in electronic form, either by strictly administering exceptions to mandatory programs, or by undertaking the conversion of paper submissions into electronic form themselves.

2. Agencies incur significant costs when they acquire information in paper form and convert it into electronic form. Private sector entities providing information to the government also incur costs when they must convert electronic information kept in electronic form into paper form for submission to the to the government. It is therefore desirable in many cases for the government to acquire information in electronic form. Electronic acquisition is desirable only when the agency's use of the in-

formation is automated. When most providers of information ("filers") are technologically sophisticated, and private sector intermediaries do not already perform a conversion and submission role, it is appropriate for agencies to require filers to submit information electronically, after developing standard formats in consultation with the filer community, and after appropriate testing and transition periods. An important part of cost/benefit analysis for designing electronic filing programs is to understand how costs of changing to standard formats will be borne, and to choose the most cost effective way to standardizing or of handling different formats.

3. Agencies initiating electronic acquisition programs should explore technologies to facilitate electronic filing by small or unsophisticated entities, including the use of "smart forms." When a significant proportion of the filer community is technically unsophisticated, electronic acquisition is feasible only through intermediaries. In such cases, agencies should create economic incentives for electronic filing rather than mandating it. Part of the economic incentive to file electronically under voluntary electronic acquisition programs can be the imposition of a fee, on technologically sophisticated filers able to bear the costs, for filing on paper.

C. Release of Information in Electronic Form

Agencies maintaining information in electronic form should release information electronically at one or more of three levels, based on statutory mandates to release information, present practices with respect to paper forms of the information, and the costs and benefits of replacing or supplementing these paper information products with new electronic products having essentially the same content.

1. When publishing is mandated by statute or when paper publishing exists, agencies should promote electronic publishing of the information unless the cost/benefit analysis suggests offering a lower level of electronic release.

2. When a statute mandates public reference room disclosure, or paper products presently are made available through a public reference room, agencies should provide electronic disclosure in public reference rooms, and should release information electronically in a bulk form easily usable by electronic information resellers. Such agencies should consider the costs and benefits of upgrading to electronic publishing.

3. In other instances, agencies maintaining information in electronic form should provide for access to such information in electronic form in response to FOIA requests, and consider the costs and benefits of

upgrading release of appropriate parts of this information to electronic disclosure through public reference rooms and wholesaling in electronic bulk form to private sector requesters

D. Roles of Public and Private Sectors

1. Agencies should define the appropriate roles of the public and private sectors in providing electronic information products (including telecommunications facilities, indices and retrieval software as well as raw data) justified under Recommendations B and C based on the relative costs and benefits of privately versus publicly provided information products.

2. Agencies should presume that private sector electronic information products will continue to be provided by private sector sources, and should consult with the private sector providers to explore enhancements or pricing changes that appear desirable to further agency missions. When appropriate, agencies should contract with private sector providers to increase certainty for agencies, the providers, and information consumers.

3. If new electronic means of agency acquisition or new information products are warranted by agency missions and the private sector is unwilling to make a commitment to provide them at appropriate prices, agencies should provide them, if clearly identified non-economic and economic benefits outweigh the capital and marginal costs. Agencies should not abdicate their responsibilities to ensure appropriate levels of electronic dissemination . In some cases, the economic structure of existing private institutions, including economic or technological barriers to entry, may inhibit competitive forces. Prices for electronic information may be high, inhibiting wide public access. Information content or retrieval methods may be inadequate. Or, there simply may be no private provider of the particular category of information. In such cases, agencies should take affirmative action to ensure appropriate levels of public access. The action need not involve agencies directly in disseminating information directly to public consumers; it may involve creating incentives, including subsidies for private dissemination, free use of agency-developed software, or a commitment for the agency to restrict its own retailing of value added information.

E. Determination of Costs and Benefits in Evaluating Available Electronic Information Products

1. Agencies should take into account the following costs in decisionmaking processes suggested in Recommendations B, C and D:

a. Capital costs to the agency of establishing the product, and the probable economic life and other uses over which the costs should be allocated;

b. Capital costs to information consumers to utilize the product, and the probable economic life and other uses over which these costs should be allocated;

c. The marginal costs to the agency for user access;

d. Marginal costs to users for obtaining the information;

e. Unrecovered costs associated with existing government or private sector capital that would be made obsolete by the new product; and

f. Capital and marginal costs to consumers of substitute sources of information if the product is launched but not maintained or funded to permit its intended benefits to be realized over its planned term.

2. Agencies should take into account the following types of benefits in decisionmaking processes suggested in Recommendations B, C and D:

a. Cost avoidance associated with eliminating the cost of producing existing paper products;

b. Cost avoidance associated with agency and consumer costs of making and responding to paper FOIA requests;

c. Cost avoidance associated with agency and consumer costs of retrieving information from and maintaining public reference rooms;

d. Increase in the number of interested persons having access to information;

e. Improvements in the utility of information for its intended purpose because of improved organization and retrieval possibilities; and

f. Reductions in delays associated with transferring information from an agency to eventual consumers.

3. Cost-benefit analyses should take into account FOIA obligations. In designing electronic databases, agencies should consider explicitly the types of FOIA requests likely to be received for data in the database. Insofar as it is consistent with agency mission performance, databases should be designed so as to facilitate, or at least not to impede, FOIA access. The rule of thumb should be that it should not be any more difficult for FOIA requesters to obtain data after automation than before.

4. In some cases, effective design, motivated by responsiveness to agency missions, or by making information effectively available electronically to a wider spectrum of the citizenry, will require some sacrifices in FOIA retrieval capability. In these cases, agency designers should consider how FOIA requests can be satisfied consistent with the spirit of the Act. This might mean budgeting for higher costs of satisfying FOIA requests that should not be shifted to requesters because it would increase the cost of searches above costs of paper retrieval. Or, it might involve making raw data available on magnetic or optical disk to requesters along with retrieval software so that requesters can massage the data and effect their own retrievals.

5. In other cases, new electronic information products may reduce costs, to both requesters and agencies, of FOIA requests. This would occur, for example if certain information were published electronically or disclosed electronically in a public reference room rather than only through a paper FOIA request, as contemplated in Recommendations C(2) and C(3).

F. Monopoly Over Public Information

No federal agency should grant monopoly power to a private firm over public information in possession of the agency.

G. Format of Information

1. Agency electronic acquisition and release systems should incorporate state-of-the-art technology as to security, format standards, and telecommunications techniques.

2. Agency electronic acquisition systems should include appropriate access control and other techniques to minimize security problems.

3. Agencies should seek to develop electronic information formats through existing standards efforts such as ANSI X.12 (EDI) before embarking on sui generis format definitions.

4. Agencies should use Public Data Networks whenever possible rather than developing their own communications links for public filers or consumers. Telecommunications systems adequate for wide public dissemination rarely are a byproduct of agency automation efforts. Many such telecommunications systems exist, however, easily accessible by ordinary telephone from anywhere in the world. Agencies can make arrangements with such Public Data Networks to aggregate information for electronic acquisition programs, or to provide wide public access for electronic release programs.

H. Administrative Procedure Act Proceedings

Agencies should experiment with electronic means of providing public participation in rulemaking and adjudication under sections 553, 554, 556 and 557 of the Administrative Procedure Act, making suitable provisions for those wishing to participate but lacking the means to access the electronic information.

I. Government-wide Electronic Information Policy

1. A government-wide electronic information policy is desirable to afford guidance to agencies. Such a policy should articulate goals consistent with those expressed in Recommendations A to H.

2. OMB should adopt guidelines for agency electronic acquisition programs as well as for electronic release. These guidelines should address with particularity cost-benefit and funding problems and offer guidance on how consultation between agencies and private sector information providers can be accomplished consistent with procurement and contracting regulations.

3. The most appropriate role for the Congress is to make the larger value judgments involved in formulating government-wide policy. The Congress should decide the degree to which, and the circumstances under which, the government should hold back its own value-added information products in order to protect markets for the private sector.

4. Instead of micromanaging agency electronic acquisition and release programs, the Congress should exercise oversight of agency compliance with generic policy guidelines, including scrutiny of agency classification of information types as suggested in Recommendation C, and agency consideration of private sector capacity to provide appropriate service and price levels. Agencies are in the best position to assess these factors, subject to appropriate Congressional oversight. When agencies have offered rational justifications for their electronic information programs, the Congress should defer to agency judgment.

J. National Institute of Standards and Technology

The National Institute of Standards and Technology should continue to work with USPTO to advance optical disk storage technology, and should continue and intensity its effort to inform agencies about commercially available products and services to facilitate electronic acquisition and communications.

K. Administrative Conference of the United States

1. The Administrative Conference should continue to facilitate government-wide consideration of appropriate electronic information policy and technology alternatives.

2. The Administrative Conference should develop resource materials for agencies to use in evaluating Artificial Intelligence techniques for incorporation in agency information management systems.

3. The Administrative Conference should continue to monitor major agency electronic acquisition and dissemination systems and prepare updates from time to time on the issues identified in this report.

Comment on Recommendations

The recommendations begin with the FOIA because that statute is broadly applicable to all agencies, with important implications for how agency-specific electronic release initiatives should be conducted. Recommendations B, C, D, and E should be considered together. Recommendation B offers principles to guide decisionmaking about what electronic acquisition systems are desirable. Recommendation C offers principles to guide decisionmaking about what electronic release systems are desirable. Recommendation D offers principles for defining the most appropriate roles of public and private sectors in those systems passing the tests in Recommendations B and C. Recommendation E lists cost and benefit categories to be considered under Recommendations B, C and D.

These recommendations do not address some important issues in detail, such as specific techniques or legal theories to protect trade secrets or privileged commercial information, to prevent disclosure of information that would invade personal privacy, or otherwise to enhance security of electronic databases. These subjects deserve separate investigation.

Freedom of Information Act.

Recommendation A covers the Freedom of Information Act, encouraging agencies and courts to interpret the Act to cover electronic information. The recommendation acknowledges that specific controversies under the Act cannot be resolved soundly until agencies and requesters gain further experience with electronic information.

The change in the form in which information is kept, indexed, and retrieved should not erode the spirit of the FOIA by increasing the frequency with which agencies decline access altogether, by forcing requesters to take data in gross in forms usable only by the technologically sophisticated, or by forcing requesters to obtain information from private sector providers instead of from agencies directly. Relational database technology makes it difficult to articulate abstract principles, saying that agencies should never be obligated to create new databases under the FOIA. In a sense, all queries in relational databases produce new databases. Case by case interpretations are necessary.

In many respects, the FOIA issues and the "electronic publishing" issues addressed in Recommendations C to F are independent. The FOIA involves a statutory access mandate and gives rise to controversies over interpretation of statutory terms and legal rights and obligations. Electronic publishing involves a broader array of policy and economic judgments involving the best way to provide information products in a market economy, while also occasionally raising issues about the scope of an agency's mandate and authority.

Nevertheless, there are inter-relationships between the two subjects. It is conceivable that agencies might be so zealous in restricting themselves to wholesaling of electronic information in order to serve policy judgments about the role of the private sector (see Recommendation E) that they would impede FOIA access.

Conversely, certain interpretations of the FOIA are incompatible with an agency's limiting its role in release of electronic information only to a wholesaling function. If the FOIA requires an agency to afford direct computerized links to computer databases, charging only the actual, marginal, cost of the retrieval, the agency effectively has been forced into a retailing role, because it must make available indexing and retrieval software in order to provide the requested access.

As more experience is gained, it may be appropriate for the Congress to consider matters such as how "programming" costs should be borne, and whether retrieval software is a "record" disclosable under the act.

Electronic Acquisition of Information

Recommendation B suggests factors to be considered in deciding whether agencies should acquire information in electronic form. Allocating responsibility between public and private sectors is addressed in Recommendation D, and cost/benefit factors are enumerated in Recommendation E.

Electronic Release of Information

Recommendation C suggests an analytical framework for deciding if, and in what form, agency information should be released electronically. Allocating responsibility between public and private sectors is covered in Recommendation D, and a list of costs and benefits to be considered is contained in Recommendation E.

The nature of electronic publishing initiatives by federal agencies should depend on the content of the information, and its value in promoting meaningful public involvement in the functions of government or in complying with law. Agencies should evaluate possible new electronic information products in a three-step process, working from a baseline of traditional paper information products and evaluating costs and benefits of electronic information products with essentially the same content. The first step in the evaluation process should be to identify the form in which information that would be contained in a new electronic information product currently is released: (1) released only in response to FOIA requests; (2) released through a public reference room or some similar means that facilitates public disclosure; or (3) published and distributed by the government or by the private sector.

The second step is to identify the benefits and costs of replacing or supplementing existing means of release with different forms of electronic release, specifically including: (1) release of electronic information only only in bulk or in response to FOIA requests; (2) release of electronic information only through public terminals in public reference rooms; or (3) electronic publishing, involving on-line, dial-up access or sale and distribution of magnetic optical disks formatted so as to permit easy retrieval on a small computer. An electronic information product should not be proposed by an agency unless the cost/benefit analysis demonstrates that the electronic alternative analyzed is superior to existing means.

In some cases, of course, a new electronic information product involving publishing is warranted despite the absence of a comparable paper product. One clear example is the electronic database of hazardous materials explicitly mandated by the Superfund Amendments. In other cases there is no statutory mandate but the benefits of a new product are appreciable and the costs are so much lower than for a paper equivalent that a new product is warranted. An example is the Federal Energy Regulatory Commission's electronic bulletin board of commission documents.

Three categories of information release are useful, the highest level ("dissemination") involving retailing or publishing, an intermediate level ("disclosure") involving wholesaling or public reference room availability, and the lowest level ("access") involving ad hoc release in response to discrete requests. One could define slightly different categories based entirely on the probable economic demand for information instead of on legal obligations. To a considerable extent, a strong economic demand for information reduces the need for aggressive agency electronic publishing initiatives, or at least makes it more likely that the private sector will retail the information effectively if the agency restricts itself to a wholesaling role.

Electronic publishing is the highest level of electronic information release. It typically includes dial-up access to databases maintained by the government or the private sector, or ready availability of data on disks or tapes in a form that can be used immediately on a small computer using accompanying or commercially available software. Electronic publishing is warranted when agencies are expressly required by statute to provide for electronic publishing, as under the Superfund Amendments or the 1987 EDGAR legislation. In other cases, a statutory mandate for, or a long practice of, paper publishing raises a presumption that electronic publishing should be viewed favorably. Examples include information contained in the Congressional Record, the Federal Register, codifications of statutes, regulations and judicial opinions, economic statistics, weather forecasts and warnings, the contents of regulatory dockets, information to promote regulatory compliance and patent information. Deciding to "promote" electronic publishing under Recommendation C does not necessarily mean a direct, retail, electronic publishing and distribution role for the government, if private sector electronic publishing activities and commitments are more cost effective (see Recommendation E). Electronic publishing contemplated by this recommendation also can occur through depository libraries; for example, through access terminals in, or dial-up access through, depository libraries. In many cases, it is appropriate to release both paper and electronic versions of the same information, even though costs almost certainly will be higher than for either form alone.

Electronic disclosure through public reference rooms is an intermediate level of electronic release. This level of release is presumptively appropriate when statutes explicitly require access to paper information in public reference rooms or when there is a long practice of making it available through that channel. Tariff information is included in this category, though it possesses special legal characteristics. When paper information is provided through public reference rooms, agencies also should consider the costs and benefits of upgrading to electronic publishing.

Recommendations A and C(3) cover agency obligations under the FOIA. Agencies also should consider the costs and benefits of upgrading release of information presently made accessible only in response to discrete FOIA requests to electronic disclosure under Recommendation C(2) or electronic publishing under C(1).

Roles of Public and Private Sectors

Recommendation D suggests how responsibilities should be allocated between public and private sectors. Agencies should define the appropriate roles of the public and private sectors in providing electronic information products (including telecommunications facilities, indexes and retrieval software as well as raw data) justified under Recommendations B and C based on the relative costs and benefits of privately versus publicly provided information products.

After the evaluation process contemplated by Recommendations C and D, agencies should identify paper and electronic information products available from private sector sources, and consider explicitly the relationship between those products and natural byproducts of agency automation activities. This step necessarily involves evaluating appropriate pricing levels for the information product. In many cases, the public sector will provide only FOIA access or public reading room disclosure, and/or bulk electronic data in raw form, and the private sector will take information released through one of those methods by the government and perform a value-added publishing function, delivering a more easily usable product directly to consumers.

Electronic information products identified and evaluated favorably under Recommendation C should be evaluated further to decide whether the public or the private sector should "manufacture" and "distribute" the product. This decision requires identifying costs and benefits associated with public sector "manufacturing" and delivery of the product compared with the costs and benefits associated with private sector "manufacturing" and delivery of the product. In this context, both "manufacturing" and "delivery" involve adding value. Manufacturing involves reformatting and structuring data and developing software to facilitate retrieval and ultimate use. Agencies should distinguish between that part of electronic publishing that involves adding value in the form of search and retrieval software and indexes, from that part of electronic publishing that involves providing telecommunications links.

Frequently, the computer hardware and software necessary to permit effective agency use of computerized information permits, with little additional cost, public access. Such agency automation byproducts may include indexes and retrieval software. Thus the capital costs to the government, under Recommendation E(1)(a), may be less than capital costs to private sector providers for "manufacturing" the same information product. Usually, however, distributing the product to ultimate consumers via direct public access would involve agency expenditures for communications facilities, which may not cost the government less than private sector providers.

Absolutely restricting an agency to a wholesaling function is artificial. The wholesaling concept implies that agencies release only raw data, and not add value in the form of indexes, retrieval software, or dial-up telecommunications access. In virtually every case, however, an agency must develop retrieval software and indexes in order to make use of the raw data internally. The costs of these two types of added value will already have been absorbed by the agency. Restricting the agency from making these indexes and retrieval software available to the public therefore erects an artificial barrier to public access in order to protect private markets. Moreover, it is not altogether clear that either indexes or retrieval software in electronic form can be protected from access under the Freedom of Information Act. Accordingly, it is prima facie appropriate for agencies to add value, and thus to retail, to the extent of making publicly available their own retrieval software and indexes. They should, however, also make data available in a form that will facilitate private sector development of different or better retrieval methods and indexes.

Dial-up dissemination via telecommunications lines is another matter. The sophistication and cost of a telecommunications interface for an agency database varies in proportion to the number and dispersion of persons seeking information from the database. Rarely would an agency construct a telecommunications dissemination system for its own internal use of data large enough for widespread public use. It is prima facie inappropriate for agencies to undertake large scale public dissemination telecommunications interfaces unless (1) there is reason for believing that the private sector will not provide adequate dissemination, (2) dissemination via depository libraries will not be sufficient in terms of the scope of information available through those intermediaries or in terms of delays before it will be available, or (3) the nature of the information places it in the highest category warranting public expenditure to make it widely available.

Agencies should distinguish between that part of electronic publishing that involves adding value in the form of search and retrieval software and indexes, from that part of electronic publishing that involves providing telecommunications access. Such a distinction permits a principled distinction to be drawn between easy-to-use electronic disclosure in an agency public reference room, and nationwide dial-up dissemination. One useful approach may be to rely on the private sector to handle electronic communications between the public and agency databases, to administer cost recovery user-fee systems, and to offer private enhancements to agency supplied information.

In some cases, the overall cost/benefit analysis of electronic publishing will suggest a government subsidy for private information providers rather than direct performance of the entire electronic publishing activity by the agency itself.

Making government information decisions depend on existing private sector activity is controversial because it may result in establishing artificial policy-based restrictions on government dissemination of public information in order to protect private markets. Yet, an example familiar to most lawyers illustrates the appropriateness of such a policy in at least some circumstances. The government does not publish the opinions of the United States Courts of Appeals in a form readily usable by persons using them for legal research. Rather, the courts publish individual slip opinions and leave it to the private sector to compile the opinions into paper and electronic products readily usable by lawyers. West Publishing Company publishes the opinions in a series called Federal Reporter Second, which is treated by lawyers and courts as the official source of judicial precedent from this level of court. In addition, West Publishing and Mead Data publish the opinions electronically in their WESTLAW and LEXIS databases. No apparent benefits would result from the federal courts deciding to publish a competing set of court of appeals opinion reporters in paper; nor would there be apparent benefits from the federal courts' undertaking to publish the opinions electronically. Costs to the court system and to West and Mead would increase if such government competition were to occur. This conclusion would change only if some new computer technology should evolve and be widely available to the consumers of this information and the existing opinion publishers did not embrace the new technology for some reason.

Even when the government undertakes new electronic acquisition or release activities, they will coexist with existing or new private sector electronic information products. Potential controversy exists in electronic acquisition programs over whether agencies should acquire information directly from the generator of the information or through intermediaries who may already be involved in processing it for government use. (See Recommendation B)

Electronic information policy should seek to mobilize market forces to ensure availability of information at a price no greater than distribution costs resulting from the best available technology. Diversity of electronic information products is desirable. It is also desirable to enable market forces to improve efficiency and reduce price. Agencies should not frustrate market forces by protecting markets for information to create a monopoly for their own automated systems, or to protect markets for contractor systems. In some cases improved or cheaper public access may be the natural byproducts of agency automation. When that is the case, agencies should consider carefully how improved access can be obtained without driving private enterprise out of the market. Agencies also should recognize the social costs of "dumping" information products at prices lower than those necessary to encourage private capital investment.

Electronic retailing and wholesaling are not mutually exclusive: the government might retail to some degree but also wholesale to private sector information resellers who would create retail information products different from those offered by the government. This is expressly contemplated by Recommendation D(2).

For example, agencies might engage in electronic publishing, providing direct "retail" public disclosure, while still preserving opportunities for private enhancements such as "one stop shopping" for wider categories of information or improved search and retrieval techniques.

Conceptually, the government could contract with a private sector information provider, obligating the private sector provider to make the product covered by the contract available for a particular term. In exchange, the government could commit itself not to compete with the private sector product. The government's promise would be not to add value. The government still would be free—and would be obligated to—disclose information in bulk, in other words, to wholesale information to any potential competitor.

Evaluation of Costs and Benefits

The evaluation process proposed in Recommendations B and C presupposes the existence of a cost and benefit framework to guide the evaluation. Specific costs and benefits obviously will be different for each proposed information product. Certain categories of costs and benefits should be considered in every case, however.

Costs are easier to measure and compare than benefits because of the existence of a common monetary denominator. Benefits are inherently difficult to quantify, but they can be identified.

Recommendation E(2) emphasizes cost avoidance. Cost reduction permitted by a new information product is considered as a benefit in this analytical framework. Alternatively it could be considered as a cost with a negative sign to permit dollars to be traded off against dollars. Benefit categories E(2)(b) and (c) would be associated with upgrading the level of information release from ad-hoc FOIA access to electronic disclosure in a public reference room and upgrading paper public reference room disclosure to electronic dissemination.

Monopoly Power Over Public Information

Agencies may be tempted to grant monopolies over electronic information to encourage private sector entities to add value or to support agency price levels necessary to recover capital costs. Monopolies inhibit market forces and reduce efficiencies and innovation available through the marketplace, and are difficult to maintain without interpreting the FOIA in a way inconsistent with Recommendation A. Therefore, no federal agency should grant monopoly power over public information in possession of the agency.

In some cases, however, agencies may wish to encourage voluntary participation in electronic acquisition programs by giving participants preferential rights to electronic information. Such preferential rights may be characterized as a kind of monopoly, but nevertheless may be warranted when they are clearly justified in terms of participation incentives and are temporary in nature.

Administrative Procedure Act Proceedings

A few agencies have begun exchanging information electronically in the course of rulemaking or adjudicatory proceedings. Ultimately, there is no reason why the Federal Register cannot be published electronically as well as in its present paper form. Such initiatives are desirable and further the purposes of the publication and public participation provisions of the Administrative Procedure Act. No legislation is required until further experience occurs with such concepts.

Further Administrative Conference Activity

The Administrative Conference should continue to facilitate government-wide consideration of appropriate electronic information policy and technology alternatives. The Conference can develop resource materials for agencies to use in evaluating artificial intelligence techniques for incorporation into agency information management systems. While it may not be feasible or appropriate for the Conference to maintain a library of information, it could develop indexes of agency personnel with experience in electronic acquisition and dissemination systems, agencies providing services and equipment to other agencies, whether on a cost reimbursement basis or otherwise, and technical references, especially on artificial intelligence and "expert systems," and all relevant laws, regulations, OMB circulars and policy statements government electronic system acquisitions. Such activity would be of particular use to smaller agencies like the FMC. The Conference could continue to monitor major agency electronic acquisition and dissemination systems and prepare updates from time to time on the issues identified in this report.

I. INTRODUCTION

A. Context

Information long has been recognized as playing an essential role in a democratic political system. The right of citizens to exchange information about public policy is protected by the speech and press clauses of the First Amendment. Citizens are protected against intrusive government efforts to acquire information by the Fourth Amendment. Statutes such as the Freedom of Information Act[2] affirmatively grant rights to obtain information about government agencies. Other statutes, such as the Paperwork Reduction Act[3] seek to reduce the burdens of government information acquisition efforts. The rapidly advancing revolution in information technology raises anew many of the economic and policy issues debated, legislated about and litigated in the context of these established public documents. The technology makes it possible for agencies to acquire information electronically; the technology makes it possible for agencies to release information electronically.

The new electronic means can improve access and reduce paperwork, but they also can impose significant economic burdens and threaten the position of established electronic information enterprises.

Electronic acquisition programs reduce costs to both agencies and filers of information with agencies. Once information in acquired in electronic form, and handled by the agency in electronic form, much of the investment in computer hardware and software has been made that otherwise would be necessary to provide for release of the information to the public in electronic form. The relatively low marginal costs for releasing electronic information to the public raise many questions about how government agencies should define their roles in disseminating electronic information and how they should price it.

This report concerns two particular aspects of federal agency information management: acquisition of information from persons outside of the agency, and release of information to persons outside the agency. It does not address, except peripherally, internal agency use of information.

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[2] 5 U.S.C. §552 (1982).

[3] 44 U.S.C. §§3501-3520 (Supp. 1986).

The Securities and Exchange Commission's Electronic Data Gathering Analysis and Reporting ("EDGAR") system is a sophisticated automated information acquisition and release system actually in operation. Controversy over EDGAR has made it highly visible. Other sophisticated agency programs are actually in operation by the IRS, the USPTO and the Customs Service, and planned by the FMC and others. The policy and legal issues raised by all of these programs are remarkably similar, though their resolution may differ depending on agency missions and constituencies.

This report is organized into seven major parts. Parts I is this introduction. Part II presents an overview of agency information functions and the technology available for automating the functions. Part IIII describes 23 specific federal agency programs, and provides an overview of similar state agency programs and state and federal court programs. Part IV compares the programs. Part V analyzes policy and legal issues raised by these programs. Part VI comments on some specific technology issues, and Part VII presents recommendations for sponsoring agencies, and for other government institutions with responsibility for developing electronic information policies.

Policy judgments about electronic acquisition and release systems, like other policy judgments, have a political dimension. Despite the focus of the report on technology and cost/benefit factors, decisionmakers must not forget the aphorism that politics is the art of the possible and the science of timing. There is no point in making exactly the "correct" choice according to objective factors but be denied funding or have the Congress amend authorizing legislation to dictate the terms of an electronic system. Agency decisionmakers should define affected parties and consider how their interests can be satisfied.[4]

B. Acknowledgements

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[4] *See* Perritt, *Negotiated Rulemaking Before Federal Agencies: Evaluation of Recommendations by the Administrative Conference of the United States,* 74 GEO. L.J. 1625 (1986).

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II. AGENCY ACTIVITIES AND THE TECHNOLOGY FOR AUTOMATION

This part of the report sets the stage for discussion of electronic acquisition and release systems. It reviews the universe of agency acquisition and release activities and introduces some basic electronic technology concepts.

Specific technology issues are addressed in Part VI.

A. Tasks Being Automated

Agency missions have an important influence on their acquisition and release of information. Missions span a spectrum from acquisition only to release with a combination of acquisition and release in the middle.

The Internal Revenue Service and Customs Service are examples of agencies concerned primarily with acquisition.

The National Library of Medicine, Government Printing Office, Census Bureau and the National Weather Service are examples of agencies concerned primarily with release. They must acquire information also, but the means of acquisition depends largely on methods other than imposing duties on members of the public.

The middle group includes the Securities and Exchange Commission ("SEC"), the Patent and Trademark Office ("USPTO"), the Federal Maritime Commission ("FMC"), the Interstate Commerce Commission ("ICC"), and the Department of Transportation's airline tariff function. A major objective of acquiring information for these agencies is to release it so as to inform the public.[5] An even larger group, involving virtually every agency when it makes rules or adjudicates cases, releases information about proposed decisions and acquires information in the form of comments or evidence and argument.

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[5] Regulatory agencies collect information for their own regulatory enforcement and decisionmaking purposes, but also to release it to the public to enhance market efficiency. In some cases, government information also plays a central role in enforcement of federal economic regulation. FMC certification of a tariff, for example is a statutory prerequisite to enforcing an ocean shipping rate.

1 *Acquisition of Information*

Agencies acquire information from members of the public in a variety of ways, under a variety of legal rights and duties. Entities regulated by the SEC are obligated by the securities laws to make certain filings[6] that disclose financial characteristics of the regulated entity. Importers of goods are obligated to file declarations with the Customs Service to permit import duties to be assessed and collected. Common carriers are obligated to file tariffs containing rate information and a variety of financial reports with economic regulatory agencies like the FMC, ICC, and the Department of Transportation. Enterprises seeking to market new drugs regulated by the Food, Drug and Cosmetic Act are obligated to file technical information with the Food and Drug Administration. Enterprises seeking to build nuclear power plants are obligated to file technical and economic information with the Nuclear Regulatory Commission. Persons seeking patent or trademark rights are obligated to file information with the USPTO.

The quantity and content of the information acquired in these examples varies enormously. The number of persons filing, the frequency of filings, and the standardization of information filed also varies enormously.

These differences have major implications for the characteristics of appropriate information acquisition systems. For example, if the information acquired is highly structured, in the sense that it is comprised of regular, discrete, components, it is easier for the agency to impose a standard form (paper or electronic) on filers—an important characteristic for computer manipulation of the information—than if the information is relatively unstructured with much textual description and explanation.

If the number of filers is large and their characteristics diverse, it is more important to ensure that the resources required to satisfy agency filing requirements are modest. If providers of information are also consumers of the same information after it is acquired from other providers or after processing by the agency, it is easier to construct a single electronic system that serves both functions. Finally, if filers presently work through intermediaries, it may be easier to standardize information formats, but the agency must also consider the economic interests of the intermediaries, both in terms of possible threats to their market position and their commitments to particular technology approaches.

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[6] This report uses "filing" and "filer" to refer to the conduct and entities from which agencies acquire information.

2 *Agency Use of Information*

Virtually all agencies considered in this report do something with information once they get it. The SEC and IRS make decisions to accept or reject filings in all cases, and review other filings to determine whether investigation or enforcement action is warranted. The USPTO decides whether or not to grant patents or trademarks based on information acquired. The Federal Maritime Commission and Department of Transportation review tariffs to determine whether suspension or other action respecting the rates contained therein is warranted, and certify tariffs to courts in rate enforcement actions. Even those agencies whose missions relate exclusively to release of information, such as the National Library of Medicine and the Government Printing Office, organize and format the information so that it will be most useful to the public.

Agencies with missions involving both acquisition and release frequently are motivated to collect information in electronic form to avoid costs associated with keying the information before it can be used in internal agency information systems. Once internal information management is automated, agencies realize that electronic release may be attractive as an incentive to encourage electronic filing, to generate funds to pay for electronic filing and internal processing systems or to fulfill a mission to inform the public. EDGAR is an obvious example of these motivations at work.[7]

Moreover, the hardware and software required to automate internal agency use facilitates electronic release. Database structures, indices, retrieval screens, and other information management software for agency personnel provide the same functions that the public needs to access and manipulate electronic information.

3 *Release of Agency Information*

Information release can occur at three levels: access, disclosure, and dissemination.[8] *Access* is the lowest level, and represents the most passive form of release. The agency must release information upon request but takes no affirmative steps to release information in the absence of a request. Paper information subject to access is kept in regular agency files and indexed and packaged for routine agency use; not for public availability. Information covered by the miscellaneous records provisions of the Freedom of Information Act[9] but not by other release obligations is an example. Electronic access usually is accomplished by releasing bulk information on tapes or disks, in the format used by the agency

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[7] *See* §III(A).

Disclosure is an intermediate level of release, involving some affirmative effort by the agency to make the information easily available to the general public. Regulatory dockets, SEC filings, and indices of adjudicatory decisions all are examples of information that is disclosed. Most agencies meet disclosure requirements by providing public reference rooms. Electronic disclosure involves making terminals and suitable retrieval software available in public reference rooms, and possibly at other fixed locations.

The highest level of information release involves the most agency activity: *dissemination*. This involves a high degree of affirmative agency action actually to publish the information and to distribute it. The National Library of Medicine and the Federal Register are examples of this activity. Electronic dissemination involves making available dialup links or disks containing data structures and software for easy retrieval on small computers

It is difficult technologically to draw clear lines among the three levels once information is computerized,[10] but the distinctions nevertheless are useful in evaluating policy options.[11] Electronic dissemination can be understood as a kind of "electronic publishing". Access and disclosure involve fulfilling agency obligations under the

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[8] *See* Office of Management and Budget Circular A-130, 50 FED.REG. 52730 (Dec. 24, 1985). Circular A-130 distinguishes between "access" (§6(f)) and "dissemination" (§6(g)), and an appendix explains the distinction essentially the same terms as those used in the text. 50 FED.REG. at 52745 (Appendix IV to Circular A-130).

[9] 5 U.S.C. §552(a)(3) (1982). *See* §V(F)(4)(a).

[10] *See* §VI(C) explaining why.

[11] Recommendation C makes use of these three levels of release.

Freedom of Information Act. The higher the level of release, the greater the value added. The more value that is added, the more the release activity can be described as retailing. The less the added value, the more the release activity can be described as wholesaling.

Just as filer populations are diverse and the information acquired by agencies exists in different formats, so also are information consumers diverse and the formats in which they use information different. Some agency information is highly specialized and interesting only to narrow segments of the population. Dockets for specific regulatory proceedings, and patent and trademark information are examples. Other information is interesting to broad segments of the public. National Weather Service forecasts are a clear example.

References are made throughout this report to "public" availability of agency information. In reality, a relatively small portion of the general public has access to microcomputers and therefore the technological capability to use information in an electronic form. Until every citizen has a microcomputer, the concept of "public" availability really means (1) direct availability to certain technologically sophisticated constituencies, such as investors, inventors and patent attorneys, tariff filers or medical researchers, or (2) indirect availability to members of the general public using agency public reference rooms or public libraries.[12]

4 *Private Vendor Information services*

Demands for information in electronic form have worked through the market to create a number of enterprises that take government information in paper or microphotographic forms and translate it into electronic form so that persons may use electronic technology to access and retrieve it. A number of enterprises perform this function with respect to data initially acquired by the Securities and Exchange Commission, for example, Dow Jones, Standard & Poor, and Disclosure, Inc. West Publishing Co. and Mead Data make statutes, judicial opinions and certain agency regulatory information available electronically, mostly to lawyers. Compuserve provides some agency information, including National Weather Service forecasts, in electronic form to the general public.

Some enterprises also have arisen to translate information into appropriate forms for agency acquisition. Some of these, Transax/Rates

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[12] *See* §III(H) regarding the depository library system.

[Journal of Commerce], and Airline Tariff Publishing Company—ironically enough—accept electronic information from tariff filers and translate it into paper format for filing with the Federal Maritime Commission[13] and the Department of Transportation.[14] Before the IRS Electronic Filing Project was established, major third-party tax preparers, such as H & R Block, did the same.

These enterprises generally can be referred to as "value added electronic information" firms. Obviously, their economic interests are significantly affected by major changes in the way agencies acquire information or release it.

B. Automation Technology

This section gives an overview of electronic acquisition and release technologies so the reader can appreciate what agencies are doing. Particular technology issues are addressed in Part VI.

1 *Storage*

Information is stored in three basic ways: printed images on paper, optical images on photographic film and electronically by magnetic, electrical or optical digital representations on appropriate media. Electronic storage involves three basic technologies. The first of these represents information by digital states of electrical circuits. Through appropriate coding schemes, a character of information is represented by the state of a group of discrete circuits photographically printed on integrated circuit "chips".[15] For example, each circuit can contain one bit of information, represented by whether its state is "on" or "off." Together, eight such circuits contain one byte, roughly equivalent to one alphanumeric character. This means of information storage is used for information that a computer actively is working on. It is fast, relatively expensive, and requires continued application of electrical power in order to retain the information.

Coding schemes can be oriented toward character representation or image representation. ASCII and EBCDIC are the two widely accepted character representation coding systems. It also is possible to represent images in binary digits. The images might contain characters or numbers, but the image representation does not "know" what the characters are, representing them simply as shapes. Images, whether of entire pages or portions thereof, can be represented as a series of digital bits representing nearly microscopic dots making up the image (a "bit map"), or as codes representing graphic objects such as lines, circles and rectangles in terms of size, position and orientation. Image and character representation can be combined to some degree, as in page makeup languages that specify individual characters and graphic objects by style, size, orientation and position on the page.

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[13] *See* §III(E).

[14] *See* §III(I).

[15] Colloquially, this is called random access memory ("RAM").

Essentially the same coding schemes can be applied to two other means of information storage that are nonvolatile.[16] The first of these represents information by groups of magnetic fields created on magnetic tape or magnetic disks. The second of these involves using a laser to burn microscopic dots on a plastic disk.[17]

Information stored on magnetic disks or tapes can be retrieved by reading the disk or tape in an appropriate drive with a head that determines the orientations of the magnetic fields on the medium. Information stored on an optical disk can be read[18] by a laser beam, which detects the dots burned by the earlier beam.

Even though electronic methods of storing information require much less physical space than paper or photographic methods, the capacity of a single reel of tape, a single magnetic disk or a single optical disk is finite, and present technology requires many such reels or disks to store the quantities of information usually acquired by federal agencies. To give concreteness to the discussion, the typical reel of tape[19] can store approximately 150,000 pages of character information, a magnetic diskette typically used in a microcomputer can store about 300 pages, a typical microcomputer hard disk can store about 20,000 pages, and an optical laser disk can store on the order of 600,000 pages. By way of comparison, a complete law library contains about 20 million pages,[20] and the USPTO files contain roughly 8 billion pages.[21]

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[16] Nonvolatile means that electrical power need not be applied to retain the information.

[17] Compact Disk Read Only Memory ("CDROM") is a type of optical disk storage.

[18] Newer technology also permits information to be written, using the same basic approach.

[19] A 2400 foot reel of tape has a capacity of 150 megabytes.

2 Telecommunications

There are several ways of transferring information between computers. Both electronic acquisition and release involve one or more of these electronic transfer methods. One way is to write the information from the source computer to a physical medium like magnetic tape, magnetic disk, or optical disk. Once the physical medium physically has been delivered to the destination computer, it can be read by the destination computer. Another way is to establish a communication link between the two computers. The source computer transmits the information over the communications link and the destination computer receives it. The communication link may be a direct electrical connection, as exists on microcomputer local area networks. It may be established temporarily via the telephone system, either on a regular voice-grade line or on a high speed dedicated telephone line. It may be a microwave radio link, either a direct link or a link using a satellite in geosynchronous orbit.

Specialized common communications carriers ("Public Data Networks" or "PDNs") exist that bundle or aggregate small volume data communications and thereby reduce the costs of higher quality communications links. For example, Telenet[22] and Tymnet[23] accept data from regular telephone line connections or from high speed dedicated lines, process it, divide it into "packets",[24] continuously check for errors introduced by noise on the communication link, route it, and eventually deliver it to its destination via regular telephone line or more frequently via high speed dedicated links. Typically the subscriber having a contractual relation with a PDN is a large volume provider of electronic information. Individual users need not subscribe; they simply dial a local telephone number for the PDN, enter an appropriate access code, and the PDN connects them with the subscriber's database. The subscriber is billed for individual user access to its database.

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[20] Based on the size of West Publishing Company's National Reporter System.

[21] These examples assume 1,000 characters per page -- about the amount on a double-spaced typewritten page.

[22] A service of GTE.

[23] A service of McDonnell Douglas.

[24] Packet approaches enhance security, because one packet usually contains only a small portion of the total message.

Some common communication services like Western Union's Easylink, and MCImail, offer electronic store-and-forward "mailboxes" so that the destination computer need not be connected to the communication link at the same time that the source computer transmits information.

Standards for transferring data over communications links are well established. Some standards pertain to the handling of data in the link, such as the X.25 standard covering packet switching. Others relate to the formatting of textual or numeric information so that the source and destination computers understand the information in the same way. Two such formatting standards are of particular interest: ASCII[25] and X.12.[26]

Each of the basic methods of transferring information has advantages and disadvantages. Transfer by physical medium avoids the expense and uncertainly of establishing a stable communications link. In addition, most computers can read and write magnetic or optical media much more rapidly then they can send or accept information over a communication link. A fifty page textual document can be written to or read from an ordinary microcomputer floppy disk in less than a minute. The same document would require about ten minutes to be transmitted via a low speed telephone link.[27] On the other hand, communication via physical medium requires that the medium be transferred physically between the two computers, and thus is not nearly as fast as communication via a communication link when the computers are separated by a significant distance. Also, the standards for formatting information on physical media are not as well established as for communications links. Thus it is more likely that a variety of formats, presenting compatibility problems, would be experienced by any system relying on physical media.

3 *Indexing and Data Structure*

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[25] *See* §VI(A)(2)(b).

[26] *See* §VI(A)(2)(a).

[27] Assuming a baud rate of 1200, the most common rate for microcomputers using regular dial-up telephone line links in early 1988. 2400 baud is fast replacing 1200 baud as the standard rate for small computer telecommunications.

Electronic information can, of course, be written, transferred, read and discarded immediately, but agencies keep electronic information for repeated retrieval and use. A collection of information designed for retrieval is called a *database*. Databases are collections of information arranged for efficient computer selection and retrieval of portions of the information. Usually, databases contain structured information, but they need not. A pure text database has no structure except for syntactic elements like words, sentences and paragraphs. In free-text databases, the information exists in natural language text, much as it might be created by word processing software, with minimal formatting and structure. In structured databases, the information is organized into fields and records to facilitate retrieval.

A free-text database permits designers to defer deciding on likely selection and retrieval criteria until a search actually is formulated in terms of "key words"; the database is not designed around any particular selection and retrieval strategies.

Information in a free-text database may have little structure when information is entered, but the computer software creates a structure. Each word (excepting words like "a," "an," "the," and "this") in a free-text database is indexed with pointers to documents, pages, and sometimes paragraphs and sentences in which the words appear. This is called an "inverted file" or "inverted index."[28] Sophisticated free-text database software can construct selection criteria from Boolean conditions, e.g. "'evaluation' WITHIN SAME PARAGRAPH 'excellent' AND ('termination' OR 'dismissal' OR 'discharge')". For this indexing and pointer system of selection and retrieval to work, the text must be organized into documents, with the documents optionally subdivided into numbered pages, and possibly numbered paragraphs. The finer the subdivisions, the more precise the retrieval, but the more work that must be done to "tag" textual elements when it is put into the database.

Database structure and associated indexes or "data tags" are needed in order to retrieve information efficiently from electronic storage. For example, if Consolidated Widget Company files an electronic 10K[29] on March 31, 1988, and the information filed becomes a part of an electronic information base, it is virtually certain that someone will wish to retrieve the information by the name of the filer and by the filing date. It is possible for a computer to search every character in the database and to locate every instance in which the series of characters, "Consolidated Widget" appears.[30] Such a character search and matching approach suffers from a number of disadvantages, however. The approach inherently requires that every character in the database be retrieved and compared with every character in the search phrase.[31] Even with the high speed of modern digital computers, this can take a long time in a large database. Also, the phrase, "Consolidated Widget" might appear in the database even when Consolidated Widget is not the filer.

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[28] Database indices are discussed more generally in this section, *infra*.

[29] A 10K is a type of corporate form filed with the SEC.

To mitigate these problems, virtually all computer databases impose some kind of structure on their content.[32] Information in structured databases is organized into different elements or fields and instances or records, according to what the designer anticipates will be the search and retrieval requirements. Information that is related because it is part of the same transaction or entity typically becomes a "record." Thus a single 10K from one filer would be a record and a 10K filed by another firm, or by the same firm on a different date, would be another record. Separate pieces of information within records typically are organized into fields. Within a single record, the name of the filer might be a field, the filing date might be a separate field, and the body of the 10K would be one or more separate fields. Imposition of structure on the data permits the computer unequivocally to know that a particular character string represents the filer name and another character string represents the filing date.

The White Pages of the telephone book is a non-electronic example of structured data. In the White Pages, each line is a record. Within each record, the last name is a field, and the telephone number is another field. The White Pages has a more regular structure than the Yellow Pages, where display advertisements arrange different information elements differently. It would be easier for a computer to retrieve information from the White Pages than from the Yellow Pages, assuming the information were represented electronically.

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[30] Such a series of characters is called a "character string."

[31] Many different search algorithms exist which do not involve matching every character. The point made in the text however, that non-indexed searching is slower than indexed searching, is valid.

[32] *See generally* H. Perritt, HOW TO PRACTICE LAW WITH COMPUTERS, ch. 6 (1988, Practising Law Institute, New York).

Data tagging or data coding refers to the organization of electronic information. Tagging refers to marking textual units such as headings, pages, paragraphs, and sentences for inclusion in a free-text database. Coding refers to associating data elements with particular fields in a structured database.

As explained *supra* in this section information in a free-text database may have little structure when information is entered, but the computer software creates a structure in the form of an inverted file, linking each word in the database to documents, pages, paragraphs and sentences in which the words appear. For this indexing and pointer system to work, the original text must be tagged at document, page, paragraph and sentence boundaries. The more precise the retrieval desired, the more work that must be done to "tag" text when it is put into the database.

Despite the labor required to tag free text information, the tagging process inherently requires less skill than coding information for a structured database. Tagging free text usually involves identifying syntactical units, like pages and paragraphs; not making substantive characterizations of content.

Retrieval is made unambiguous, but only slightly more efficient, by tagging or coding information. To improve retrieval efficiency, one should relieve the computer from having to compare characters in all name-of-filer fields in order to select the appropriate 10K record. This strategy requires construction of indices for fields likely to be used in retrieval. Thus, regardless of the order in which records actually are entered into the database, the database management system automatically would construct and maintain an alphabetic index for the name-of-filer field. Then, when a user requests a 10K filed by Consolidated Widget, the database management software need consult only the alphabetical index, beginning with the 'Cs', to identify the records matching the request. Similarly, as explained *supra* efficient free text databases index all the words in the database likely to be used for retrieval.

Virtually every database requires a certain amount of fielding of data and indexing of information contained in "key" (search) fields. Indexing, of course, adds to storage requirements. A typical free-text index requires as much space as the text itself, and indices to permit proximity (Boolean combinations of words and phrases) searches adds to storage requirements even more.

Some kinds of data tagging or coding present special challenges. Securities filings, for example, contain financial information that, in a really useful electronic information base, could be searched for. For example, a user might wish to retrieve the filings for companies reporting more than $1 billion in revenues, or for all companies reporting a current ratio less than a specified amount. Permitting such searches and retrievals requires fielding and indexing of all financial information that might be the subject of a search. It does not do much good to retrieve the number $1 billion from unfielded text because of the many different meanings that the number $1 billion may have, not limited to revenues. Thus, in addition to a name and date field in a 10K record, one would like to have a field for total revenues and fields for current assets and current liabilities from which the current ratio was calculated.

This need, however, presents a major conflict between data retrieval goals and format compatibility goals.[33] In order for filings to be fielded, the user must specify which information belongs to which field. Such specification requires formatting codes. These need not be complicated; the third line of the filing, for example, could contain revenues, and the fourth and fifth lines could contain current assets and current liabilities, respectively.[34] But the formatting must be standard. If the filer inserts an extra line at the beginning of the filing, for example, the revenue, current assets and current liabilities information will be in the wrong place, and the computer's database software will put them in the wrong fields. Alternatively, the database system design could require that some unambiguous flag like "@CurLia" precede the numbers indicating current liabilities. But under this strategy a filer must use exactly that flag, which may not be easy for a filer to do without completely changing its computer programs.

Strategies for dealing with the data tagging coding and indexing problem are discussed in the sections pertaining to the particular agency programs.

4 *Retrieval Interfaces*

Even when electronic information is structured and indexed appropriately some interface must exist so that users can specify criteria for information retrieval and see the retrieved information. One type of retrieval interface, particularly suitable for individual review of relatively small quantities of information, is an "electronic bulletin board." Many other types of interfaces exist, designed to facilitate particular uses of the underlying data. "User friendliness," involving a high degree of interactivity, help screens and menu presentations are important to casual users desiring relatively small quantities of information in a single session. Conversely, efficiency and a high data transfer rate are important to users desiring significant quantities of information at one time. User friendliness usually reduces efficiency and data transfer rates.

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[33] *See* §VI(A) for a discussion of format compatibility.

[34] The IRS electronic form 1040 is a good example of simple formatting. *See* Rev.Proc. 88-20 (Apr. 4, 1988).

a. Electronic Bulletin Boards

An electronic bulletin board is a special kind of computer database combined with telecommunications interfaces. The name "bulletin board" accurately portrays the basic idea. Data is stored in a fashion resembling notices posted on a physical bulletin board, in the expectation that a bulletin board user will access much or all of it. To permit selection of information, bulletin board "notices" typically are organized by topic, sometimes hierarchically from major subject to more specialized matters. Bulletin boards are a particularly attractive way for disseminating certain kinds of information, such as regulatory notices, press releases, and periodically updated economic data.[35] The Department of Commerce system described in section III(O), is a good example.

b. Batch Retrieval Interfaces

If an electronic information consumer wants to extract significant quantities of information from a database rather than only one or two documents, or if a consumer wants to specify complex criteria for selecting information, a bulletin board system is likely to impede rather than facilitate access. Such users may want large amounts of information because they intend to add value[36] and resell it.

For such users various batch retrieval techniques are appropriate, including the use of database programming languages or standards, such as Structured Query Language ('SQL").[37] In addition, such users need bulk transfer media such as magnetic tapes or optical disks or high speed telecommunications lines to permit information to be transferred to them in a reasonable period of time.

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[35] J. Wallace and Rees Morrison, SYSLAW: The Sysop's Legal Manual (1988).

[36] *See* §V(F)(1) for a description of the the types of value that can be added to electronic information.

[37] SQL is discussed in §VI(A)(2)(c).

5 *Analysis*

When agencies acquire information in electronic form or translate paper acquisitions into electronic form themselves, they must use appropriate technologies to retrieve the information to use it. If automated retrieval is all that is desired, the steps associated with data tagging and indexing, discussed in §B(3) of this part, are the only technologies required for internal use.

But other technologies, grouped loosely under the "artificial intelligence" ("AI") label, are worth considering to facilitate agency analysis and evaluation of electronic information. The most relevant AI technology is that of "expert systems": computer programs that can apply rules for selecting and displaying certain information, and taking prescribed actions, e.g. accepting or rejecting a filing, based on its content.[38] Construction of an expert system requires that human experts be consulted and forced to articulate discrete decision rules that they apply in making judgments about information.[39] For example, an SEC analyst might wish to select all the filings made between January, 1987 and March, 1988, involving the publishing industry, associated with secured debt offerings, by filers with current ratios less than one. Or, the Customs Service or the IRS might want to select certain filing for inspection or audit based on certain criteria. Such a set of selection or decision criteria can be translated relatively easily into a set of rules that then would be applied against an electronic database of SEC filings or Customs declarations to select the records of interest and generate action-oriented documents.

A separate project "ELOISE" in the SEC EDGAR pilot program used artificial intelligence techniques to identify designated concepts in filings and to prepare indexes. Testing of ELOISE during the EDGAR pilot phases was limited.[40] The Internal Revenue Service has developed a prototype expert system that reviews pension plan descriptions submitted by employers, identifies legal issues, forms conclusions about conformity of the plan with IRS policy, and explains its reasoning to IRS analysts.[41]

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[38] The boundary line between expert systems and sophisticated database retrieval algorithms is fuzzy.

[39] *See* H. Perritt, HOW TO PRACTICE LAW WITH COMPUTERS, ch. 9 (1988, Practising Law Institute, New York); Perritt, *Artificial Intelligence Techniques for Evaluating Employee Terminations on a Personal Computer*, 13 Rutgers Comp. & Tech. L.J. 341 (1987).

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[40] MITRE Corporation, Securities and Exchange Commission EDGAR Pilot System Evaluation Report, at 2-11 (MITRE Working Paper 85W00635 Jan. 1986), *reprinted as* Appendix III to 1985 SEC EDGAR Status Report. [hereinafter cited as "MITRE Report"].

[41] Grady and Patil, *An Expert System for Screening Employee Pension Plans for the Internal Revenue Service*, Proceedings of The First International Conference on Artificial Intelligence and Law 137 (1987) (The Association for Computing Machinery Ord. No. 604870).

III. SPECIFIC AGENCY PROGRAMS

In the following sections describing specific agency programs, the order follows the maturity and sophistication of the systems: with the most mature and most sophisticated systems considered first.

A. SEC's EDGAR

The most visible and controversial sophisticated electronic system for acquisition and release of agency information is the Securities and Exchange Commission's ("SEC") EDGAR system.[42] The system is designed to improve efficiency of filing and evaluation of legally required reports by publicly owned companies, reports which totalled seven million pages, exclusive of copies, annually when EDGAR began operation.[43] Unlike some other agency initiatives discussed in this report, which private sector interests would like to kill, no one really was opposed to EDGAR. No private sector enterprise was doing anything like EDGAR envisions on as large a scale.[44]

Pilot operation of EDGAR began on September 24, 1984, with full-scale operation originally planned for 1990.[45] By the end of 1986, the third year of pilot operation, EDGAR had received more than 11,500 electronic filings from 1000 filers,[46] scheduled to increase to 4,000 filers and 30,000 documents annually by 1988.[47] EDGAR accepts filings in three different media: direct transmissions over telephone lines via asynchronous or bisynchronous protocols, diskettes and magnetic tape. During the pilot phases, users filed such reports as 8-K's, 10-K's, 10-Q's and Form 424's electronically. The average size of an electronic filing during the first year was 22 pages,[48] and average document size for the operational system is projected to be 41 pages.[49] About 45% of the filings were made by diskette, 28% by asynchronous telephone protocol, and 22% by bisynchronous telephone protocol.[50] The trend was for filers to rely on telephone filing more and diskette filing less.[51] The SEC expects the operational system to employ telephone filing predominantly.[52]

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[42] EDGAR is an acronym for Electronic Data Gathering, Analysis and Retrieval.

[43] U. S. Securities and Exchange Commission, EDGAR: a Status Report 1-2 (Dec. 31, 1985) [hereinafter "1985 Status Report"]. Nine million pages currently are involved. *See* S.Rep. No. 100-105 at 8, reprinted in 1987 U.S.CODE CONG. & ADMIN. NEWS 2089, 2096.

[44] But see LaserDisclosure, a product of Disclosure, Inc., 5161 River Road, Bethesda, MD 20816. LaserDisclosure is a new product that makes available up to 20,000 pages of original SEC filings on a single optical disk.

[45] MITRE Corporation, Securities and Exchange Commission EDGAR Pilot System Evaluation Report (MITRE Working Paper 85W00635 Jan. 1986), *reprinted as* Appendix III to 1985 SEC EDGAR Status Report. [hereinafter cited as "MITRE Report"].

[46] U. S. Securities and Exchange Commission, EDGAR: A Status Report 1

When filings are received, they are routed electronically to acceptance review analysts who accept or reject a filing after reviewing it on computer screens. After a filing is accepted, it is routed electronically to examiners who perform their analysis on IBM 3270 computer workstations. The analyst workstations can build spreadsheets from filed data, create reports and letters via local word processing software, and permit annotations to be made to any page of the filing. When a document is accepted, an electronic folder is created. After an examiner's review is complete, the electronic file folder is "closed," meaning that information no longer can be removed from the folder, which becomes an official record of the Commission.[53] The analyst workstations also permit supervisors to assign new filings to specific examiners, to check the progress of examiner work, and to establish priorities. Assignments can be made automatically, based on the type

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(Dec. 31, 1986).

[47] S.Rep. 100-105 at 9, 1987 U.S.CODE CONG. & ADMIN. NEWS at 2097.

[48] MITRE Report at 3-11.

[49] U. S. Securities and Exchange Commission, SEC Request for Proposals for an Operational EDGAR System, Solicitation No. SECHQ1-86-R-0637, Revised through Amendment 14, Appendix X Tables 2 and 3 [hereinafter RFP].

[50] MITRE Report at 3-7.

[51] MITRE Report at 3-24.

[52] RFP at 67.

[53] MITRE Report at 2-8.

of filing and name of company.[54] Examiners and their supervisors can establish simple criteria to "flag" filings for review. During the pilot phase, some filers submitted, on a volunteer basis, structured one-page summaries of financial figures[55] so the review software could compute basic financial ratios to facilitate the "flagging" process. A similar capability is planned for the operational system.[56]

Public disclosure of EDGAR information is provided by means of workstations in the SEC's Washington, New York, and Chicago offices, and by means of telephone connections from state securities agencies.[57] The workstations include basic display and retrieval capabilities.[58] The pilot program provided benefits to filers, SEC users, and the public. Filers used existing computer-stored data and existing equipment for filing, and received expedited processing. SEC staff obtained immediate access to filed documents, and simultaneous access by multiple reviewers was facilitated. SEC staff also benefited from easier access to external databases. The public gained quicker access to filings, and the ability to perform text searches of documents.[59]

For the operational system, more than 30,000 filings per day totalling more than 1 million pages are projected for peak periods.[60] A peak telecommunications capability is projected at 571,189,894 bytes per hour.[61] For 1996, peak hour requirements are projected to be 984 million bytes.[62] If all lines were asynchronous at 1200 baud, this would require about 1800 telephone lines to handle the peak filing load.[63] The operational system probably will rely on public data networks such as Tymnet and Telenet, which would reduce the number of EDGAR lines required, and provide peak load buffering capability through a "store and forward" function.[64]

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[54] March 1[illegible], 1987 discussion between author and George Eckard; RFP at 96-99.

[55] *See* §III(A)(5).

[56] RFP at 99. Section 102 of P.L. 100-181, 101 Stat. 1245, added a new §35A(b)(2)(B) to the Securities Exchange Act of 1934, 15 U.S.C. §78kk, requiring the SEC to report on technical approaches to the data tagging problem.

[57] EDGAR information is provided on an experimental basis to state securities agencies in Georgia, Wisconsin and California.

[58] MITRE Report at 2-9.

[59] MITRE Report at 2-15 to 2-16.

[60] RFP Appendix X Table 6.

[61] RFP Appendix X Table 6.

[62] *Id.* at Table 7.

During the the first six months of the pilot program, the acceptance rate for filings was only 65%, with a slightly higher acceptance rate for diskette filings than for telephone filings.[65] Most of the rejections involved improper submission headers, bad data or no filer identification code ("CIK"). Accordingly, MITRE recommended improved dissemination of information to filers and improved error checking and recovery. One problem that particularly concerned pilot program filers was the need to retransmit an entire document from the beginning if fatal errors occur in an asynchronous transmission.[66]

Based on evaluation of pilot operation, the operational system may have two types of error recovery: retransmission of filing segments rather than the entire submission ("restart capability"), and a limited amount of on-line error correction.[67]

The hardware for the pilot system centered on an IBM 4381 mainframe computer, with IBM 3270 personal computer workstations.[68] For the operational system MITRE recommended distributed departmental processors with high speed computer-to-computer data links to the main processor, which would contain the database.[69] Though the RFP for the operational system does not include hardware specifications, it includes an appendix with the projected need for an IBM 3090-200 mainframe by 1991.

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[63] MITRE projected the need for 225-425 asynchronous, and 233-635 bisynchronous telephone lines to handle the peak load, with the higher number of lines necessary to minimize the chances of filers receiving busy signals. This assumes 80% of operational filings would be by telephone rather than by diskette. MITRE Report at 3-33.

[64] RFP at 67-68, 81. *See* §II(B)(2) regarding telecommunications techniques.

[65] MITRE Report at 3-39 (covering a base of 437 filings received between September 24, 1984 and April 8, 1985).

[66] At an average of 41 pages per document (RFP at Appendix X Table 2), and 3000 bytes per page, a document requires about 13 minutes to transmit.

[67] RFP at 69-70.

[68] MITRE Report at 4-5; RFP, App. VII at 425-26.

Mainframe software for the pilot program was IBM's MVS, running CICS, with Infodata's INQUIRE database software, and Lotus' Symphony, an integrated spreadsheet and wordprocessing software package, running on workstations.[70]

Before EDGAR is fully operational the SEC must receive and evaluate mandatory filings from a "significant test group of filers for a period of six months.[71]

As EDGAR was nearing its initial operational phase in late 1986, political difficulties threatened the project. Some of these had to do with funding, and others had to do with release of electronic information.

1 *Cost and Pricing Issues*

EDGAR pricing and cost issues generated a significant amount of controversy which threatened to scuttle the program. The SEC's original plan for EDGAR contemplated that it would be self-supporting: that revenues generated from fees charged for release of the information would be sufficient to cover the costs of the acquisition and internal analysis subsystems.[72] In order to ensure an adequate fee level, the SEC planned to offer the contractor a brief timing advantage in the sale of documents filed with the SEC. Because of this timing advantage, a sufficient price level could be supported to permit cross-subsidization of the receipt and internal analysis subsystems.[73] This idea engendered opposition from the Congress which feared loss of control via the appropriations process over a self-supporting program, and from the electronic information industry, which feared loss of market opportunities if a preferred firm enjoyed a monopoly for a time.

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[69] MITRE Report at 4-4.

[70] MITRE Report at 4-9; RFP, App. VII at 427-28..

[71] Pub.L. 100-181, 101 Stat. 1249, adding §35A(c)(5) to Securities Exchange Act of 1934.

[72] *See* comments by Rep. English, Sep. 10, 1987 Cong.Rec. at H7415, describing 1985 testimony by SEC Chairman.

[73] *See* §V(F)(1) for a broader discussion of the economics of information.

As explained in the next section, the opponents of the self supporting policy won.

2 1987 Legislation

The 1987 EDGAR legislation apparently resolves most of the fundamental issues that divided the SEC, the Congress, and the information industry. The legislation requires that the receipts and internal processing functions of EDGAR be funded by appropriations, permitting only the dissemination portion to be funded by user fees.[74]

The legislation further indirectly prohibits user fees in excess of the marginal cost of disseminating the information. The legislation prohibits the SEC from giving the contractor any advantage with respect to the timing of information released to others or with respect to intellectual property rights.[75] The contractor thus is deprived of any economic power to charge prices much higher than marginal costs[76]—although some premium may be associated with mere status as the EDGAR contractor. Because the contractor is required to release raw data to anyone, on line, as soon as the contractor itself has it,[77] the economic benefit available to the dissemination contractor is small, perhaps too small to attract any bidders if this were the only function to be performed. Probably, however, bidders will be attracted by the prospect of fees available from the appropriation-funded receipts and internal processing functions even if these fees must be used internally to cross subsidize the release function. Ironically the SEC's original idea to cross-subsidize the receipts and internal processing functions from release profits has been entirely reversed. That kind of cross subsidization now is prohibited, and there is at least a possibility of a cross-subsidy flowing in the opposite direction.

3 Hardship Exemption for Filers

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[74] Pub.L. 100-181, 101 Stat. 1249, adding §35A(a)(3) to Securities Exchange Act of 1934.

[75] Pub.L. 100-181, 101 Stat. 1249, adding §35A(d) to Securities Exchange Act of 1934.

[76] Statement by Rep. English, 133 Cong. Rec. H7415 (daily ed. Sep. 10, 1987) (explaining how free access will drive contractor prices to marginal costs).

[77] RFP at 158, 166-169.

No one seems terribly concerned about the burdens flowing from a mandatory obligation to file electronically with EDGAR. Firms large enough to be within the SEC filing requirements are virtually certain to possess the technological resources to file electronically in one of the several methods permitted by the SEC, or to have the financial resources to pay a law firm, an accounting firm or a financial printer to convert paper information into an electronic submission. The 1987 legislation authorizes hardship exemptions from mandatory electronic filing.[78]

4 *State/Federal Relationships*

The major remaining political issue relating to EDGAR is the resistance of state securities agencies to the degree of standardization and control presently proposed by the SEC. SEC restrictions on state agency resale or redistribution of information provided via EDGAR could eliminate important markets and sources of economic leverage for state agencies.

5 *Data Tagging*

The issue of an appropriate data structure for SEC information, called "data tagging", has not been resolved entirely.[79] EDGAR uses character information, which facilitates retrieval of specific information elements,[80] But there is a strong history of nearly complete flexibility in how an SEC filer presents required information. Length is optional; events, financial situations, and expectations can be expressed with the richness of natural language. Yet electronic access and analysis of financial information is much easier if it is presented in a structured form.[81] Free text search is inherently less useful for numerical information than for textual information. The SEC has considered resolving this data tagging issue by requiring filers to submit one page of structured numerical information. Some filer representatives have objected strongly to this idea for fear that such a simple presentation could be misleading and therefore subject the filer to liability not associated with a fuller expression of the same information in text, with accompanying footnotes. At one point the SEC proposed not disclosing the one page of structured numerical information, but the legal permissibility of such non-disclosure is dubious. It may be that value added retailers can take care of any need for structured financial information from full text filings without the necessity of filing any structured information.

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[78] §35A(d)(2).

[79] *See* General Accounting Office, ADP Acquisitions: Lessons Learned From SEC's EDGAR Pilot Test at 23-27 (August, 1987; GAO/IMTEC-87-31) (discussing difficulties with data tagging, text searching and image processing).

[80] *Compare* §III(F), describing USPTO approach. The USPTO page image approach makes retrieval of specific elements within a page impossible.

[81] *See* §II(B)(3).

The 1987 legislation requires the SEC to report every six months until 1990 on data tagging approaches, their actual effectiveness, and filer reaction,[82] and on free text search approaches actually adopted.[83]

6 *Other Characteristics*

Several technical characteristics of EDGAR are of potential significance for other electronic filing systems:

1. Word processor compatibility problems are managed by providing for ASCII "print-image" file submission, with support for a limited number of popular word processing formats planned for the operational system.[84]
2. Format problems are minimized by permitting free-text submissions, in accordance with SEC tradition. Only a limited degree of simple header information is required at the beginning of each submission and of each document.[85]
3. Confirmation of document receipt is handled by checking the page count of the header with pages actually received, confirming receipt to the submitter electronically or by regular mail.
4. Signatures are handled by means of a Personal Identification Number ("PIN").

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[82] Pub.L. 100-181, 101 Stat. 1249, adding §35A(b)(2)(B) to Securities Exchange Act of 1934..

[83] *Id.*, §35A(b)(2)(C).

[84] RFP at 69-70.

[85] U. S. Securities and Exchange Commission, Electronic Data Gathering, Analysis and Retrieval System User Manual, Part II (1986). But see §III(A)(5), discussing data tagging controversy.

One intriguing legal question is whether adding value to EDGAR documents and making them available to investors might cause the enterprise performing this retailing function to be an "investment advisor" under the securities laws.[86]

B. IRS

1 *Tax Return Filing Project*

The Internal Revenue Service (IRS) is implementing a system that permits taxpayers to file their returns electronically. Some third party record keepers, such as large employers and banks, are required to file electronically. Electronic filing gradually is being extended to include voluntary electronic filing of individual income tax returns. Section 6011(e) of the Internal Revenue Code[87] requires the Secretary of the Treasury to issue regulations providing standards for electronic filing. Subject to a hardship exception, filers of certain returns[88] covering more than 50 payees must file electronically. Conversely, the Secretary is prohibited from requiring electronic filing by individuals, estates and trusts with respect to income tax.[89] In developing regulations, the Secretary must take into account "the ability of the taxpayer to comply at reasonable cost."[90]

Forms 1042S, 1098, 1099 series, 5498, 6248, 8027, W-2, W-2P, and W-2G (except for those attached to individual income tax forms) must be filed electronically.[91] Pilot programs are underway respecting partnership and fiduciary Forms 1041 and 1065, and Forms 1120-S, 1120S.[92]

The Electronic Filing Program, as the voluntary program for electronic filing of individual tax returns is called, began in Calendar Year 1986 with five third party return preparers. In June, 1987, the

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[86] Texas attorney Benjamin Wright has written a law review article exploring this possibility.

[87] 26 U.S.C. §6011 (e).

[88] Those required under §§6042(a), 6044(a) and 6049(a)

[89] 26 U.S.C. §6011(e)(1).

[90] 26 U.S.C. §6011(e)(1).

[91] Treas.Reg. §301.6011-2.

[92] IR-87-117 (Sep. 24, 1987).

Revenue Service announced a major expansion of the Electronic Filing Program.[93] Under the expanded program, taxpayers can file electronically through participating tax return preparers in Alabama, Arizona, Indiana, Kentucky, Nebraska, North Carolina, Utah, Virginia, Washington and Wisconsin, and selected cities in California, New York, Ohio, and Texas.[94] In Calendar Year 1988, 3,000 preparers filed some one million electronic returns.

For many years, both tax preparers and the IRS have used computers to process returns, but before the Electronic Filing Program, preparers printed electronic return information on paper forms, and submitted them to the IRS, where they were rekeyed for processing by IRS computers. The Electronic Filing Program relieves preparers of the necessity of printing paper returns and mailing them and relieves the IRS of manual batching, numbering and keying functions. The error rate for electronically filed returns also is significantly lower than for paper returns: 3% versus 21%.

Third party preparers have incentives to file electronically because of lower costs. The possibility for direct electronic deposit of tax refunds also creates incentives for taxpayers to file electronically, and has stimulated tax preparers to offer short-term loans secured by the anticipated refund as an inducement to potential customers.[95]

The requirement for a signature on returns is handled by requiring taxpayer and preparer both to sign a form 8453, which is mailed to the IRS and electronically matched with the electronic return. Other alternatives for handling the signature requirement are under active investigation by the IRS research organization.

Only overpaid returns (those on which a refund is due) may be filed electronically. Only preparers expecting to file more than 100 returns may be approved for electronic filing, and electronic returns are accepted only from approved preparers.

When the IRS preprocessor module accepts an electronic return, it sends an acknowledgement message to the sender. If the return is rejected, a message is sent to the sender indicating up to nine reasons for the rejection. Electronic returns may use either ASCII or EBCDIC character codes. Electronic returns are formatted with one logical record for each page of an IRS form. These records are formatted into fields, the first few of which contain header information such as filer number, form number, page number, and tax period. Remaining fields correspond directly to lines on the IRS forms. For example, Form 1040 field no. 450 is a 12 character numeric field for "Capital Gain/Loss." Alternatively an electronic return may have variable length fields, in which case the field number in brackets precedes the contents of the field, and the field is terminated with a # character. A trailer "summary" record includes page count information for each IRS form constituting the return.[96] The acknowledgement record sent by the IRS in the same communications session includes a record count.

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[93] *See* IR-87-72 (Jun. 8, 1987).

[94] *Id.* 52 FED.REG. 21644 (Jun. 8, 1987).

[95] In connection with cost-benefit issues discussed in §V(D), one should note that direct deposit of tax refunds may decrease the government's interest on the "float" sufficiently to increase the total costs of the system.

Electronic returns are received at one of two IRS service centers located in Cincinnati or Ogden. Each center has two dedicated 9600 baud communications lines paid for by larger preparers and 22 4800-baud dialup lines. RJ3780, X.25 and SDLC protocols are accepted. The Service has considered acquiring electronic returns via PDN[97] but has not yet resolved questions regarding fee levels and responsibility for data.[98] In addition PDN vendors desire an exclusive arrangement with the IRS, which the IRS is not willing to grant.

Most preparers, except for the largest, use computer service organizations and intermediaries for electronic filing.[99] In some cases, the service organizations only provide software, in some cases they provide the communications link, in other cases they provide a turnkey package complete with workstations. Some preparers accept floppy disk returns from taxpayers, and may offer dialup telephone access in the future.

The Service does not anticipate permitting individual taxpayers to file directly with the IRS in the near future because of the telecommunications burden on the IRS, and the need under the present signature system for third party preparer verification on the Form 8453. If arrangements with PDNs are developed and if alternative arrangements for meeting the signature requirement are adopted, the impediments to direct taxpayer filing could be reduced.

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[96] *See* generally Rev.Pro. 88-20 (Apr. 4, 1988).

[97] *See* §II(B)(2), regarding Public Data Networks.

[98] The legal requirement to file a tax return is not met until the IRS accepts a return. The duty to file is imposed on the taxpayer. The problem is one of the contractual allocation of responsibility for return data as between the taxpayer and the PDN.

[99] *See* Brandel, *Data link speeds tax filing, refunds*, Computerworld, Mar. 28, 1988, at S7 (describing H&R Block use of Blast Private Network system).

The IRS is actively seeking to enlarge the universe of third-party electronic form preparers, however, encouraging large employers to consider filing for their employees, large banks to consider filing for their customers, unions to file for their members, and universities to file for their students. Expanding the universe of preparers would increase the proportion of taxpayers with indirect access to electronic filing. The Service estimates that, at present, about 50% of the total number of individual returns are prepared by third party preparers.

The Service expects electronic filing largely to replace paper form filing in the future, and is working with interested parties to address compatibility, security and privacy, and transmission of signatures. There is virtually no likelihood of requiring electronic filing because of the enormous universe of taxpayers, many of whom never would have the necessary hardware.

The Electronic Filing Program is interesting to other agencies because it illustrates one approach to designing an electronic acquisition system for a large universe of persons obligated to file information, and because it involves a simple standardized format for data.

2 *Expert System Research*

Independently of the Electronic Filing Program, the Internal Revenue Service planning, finance and research organization has developed a prototype expert system that reviews pension plan descriptions submitted by employers, identifies legal issues, forms conclusions about conformity of the plan with IRS policy, and explains its reasoning to IRS analysts.[100] The system is intended to reduce the 350 staff years devoted to reviewing pension plans in FY 1986.[101] In a recent test, the system took data from a Form 5302, listed issues clearly meeting IRS requirements, listed issues clearly not meeting IRS requirements, and listed issues requiring further human analysis. A comparison of eight randomly selected cases showed that the system produced the same substantive results, including explanations, as human analysts and revenue ruling preparers.[102] This technology has potential for broader application in reviewing a variety of IRS submissions.

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[100] Grady and Patil, *An Expert System for Screening Employee Pension Plans for the Internal Revenue Service,* Proceedings of The First International Conference on Artificial Intelligence and Law 137 (1987) (The Association for Computing Machinery Ord. No. 604870).

[101] *Id.* at 138.

3 Image Storage and Retrieval

The IRS has undertaken a Files Archival Image Storage and Retrieval (FAISR) research test at its Fresno, California, service center. FAISR uses optical disk technology to convert paper documents to computer readable digital bit streams. Processed tax returns are scanned on high speed scanners, which include optical character recognition units to read preassigned document locater numbers. The document locater numbers permit indexing the page images for subsequent retrieval.

After scanning, the document page images are stored on optical disks arranged on jukeboxes. Caseworkers can retrieve tax return page images by entering document locater numbers, and page through the complete returns.

The research test is expected to reduce the nearly $50 million annual cost of storing and retrieving nearly 5 million cubic feet of paper IRS tax return records.

4 Issues

The IRS Artificial Intelligence and optical disk programs will provide additional empirical data on important technology issues.[103]

The Electronic Filing Program presents the same generic issues as other electronic acquisition programs discussed in this report, in different relative emphasis. Because tax return information is confidential and exempt from access under the FOIA, the Program does not present electronic release issues. The Internal Revenue Service has a tax collection mission, far different from the SEC's, tariff agencies' and USPTO's information dissemination missions. Information presently collected by the IRS is highly structured. This makes it easier to address compatibility and filing format questions and also makes it easier to design a sophisticated database. Historically a major private sector industry has been involved in filing returns with the IRS, and the Service has made effective use of the industry's historic role and technological capabilities in structuring the Electronic Filing Program.

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[102] *Id.* at 142.

[103] *See* §VI(D) and (F).

It has not been difficult to translate existing data structures designed for a paper system to an electronic environment. It is not known whether the Service considered the EDI standard, but the conventional format specifications for electronic returns seem entirely appropriate.

C. U. S. Customs Service

For more than four years, the United States Customs Service ("USCS" or "Customs") has been developing the Automated Commercial System ("ACS").[104] The ultimate goal of the ACS is to automate all phases of the commercial processing of imported merchandise in a single system.

The Automated Commercial System has two major components that involve electronic acquisition and release. The first, and older, of these is the Automated Broker Interface (ABI). The second, and newer, is the Automated Manifest System (AMS). In addition, a Line Release System automates information acquisition in connection with goods movements across the Canadian and Mexican borders.

Customs began automating its commercial cargo activities in the late 1970s. It worked closely with user communities, especially the 1500 or so brokers, who handle about 95% of cargo entries. The initial incentive to automate arose from Customs perception that it was becoming buried in paper even before the recent growth in imports. After some initial pilot programs, the service recognized that most brokers (approximately 60% according to a 1980 survey repeated in 1982) were already automated themselves, and were producing paper reports for Customs to rekey into its computer systems.

1 *Automated Broker Interface*

About 58% of the data required for Customs inspection and release activities now are handled through ABI. 420 brokers and 50 importers participate in ABI. About 85% of the importer population files information via brokers. Initial size requirements for broker participation have been eliminated. Now it is possible for any broker or importer, however small, who has the equipment and who satisfies training and qualification requirements to participate in ABI.

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[104] *See* generally 53 FED.REG. 1097 (Jan. 15, 1988).

Participating brokers and importers access ABI via some 100 dialup "800" telephone lines operating at 2400, 4800, or 9600 baud using the IBM remote batch 3780 protocol, with either ASCII or EBCDIC character representation. Filings are placed in queues, with acknowledgements or messages back to filers similarly being placed in queues which function like mailboxes to the participants.

Some 58 software and hardware vendors exist. ASA/ITS of Salem, New Hampshire, is the largest of these, and sells turnkey ABI systems to brokers.

The Service has just completed a nationwide survey of 1000 Customs Service users, and 400 AMS and ABI users. Both groups reported a high level of satisfaction with the system features and performance.

The ABI system has been supplemented with a Daily Statement module, which permits brokers to pay duties by a single check referencing a list of entries for which payment is due on that particular day. The listing of payments due is generated from ABI and posted to the broker's mailbox. A new Automated Clearinghouse module recently has been implemented, which permits brokers to send an electronic funds transfer request in payment for a batch of entries through a bank designated by the U. S. Treasury for receiving and wiring funds to Treasury via the Federal Reserve communications systems.

ACS also can apply selectivity criteria according to requests submitted by Customs inspectors around the country. By applying these selectivity criteria, ACS can identify entries that will receive only a "general examination", and identify automatically to Customs inspectors those entries that should be scrutinized in more detail. These findings also are provided to the entry files via ABI up to five working days before arrival of the cargo.

The broker community opposes direct importer and port authority participation in ABI, fearing that if automation makes it easy for importers to deal directly with the Customs service, the demand for brokers' services will decline. The Customs Service has accommodated this position by marketing ABI much more aggressively to brokers than to importers. Nevertheless, the Commissioner of Customs has initiated a Customs Service program to enlist direct importer participation as an incentive to encourage more brokers to participate.

2 *Automated Manifest System*

Section 431 of the Tariff Act of 1930[105] requires that the master of every vessel arriving in the U.S. have on board a manifest which contains, among other things, certain information with respect to the nature of the merchandise on board the vessel. Subsection (c)(1) of section 431 provides that the following information when contained on the manifest shall be made available for public disclosure:

1. The general character of the cargo
2. The number of packages and gross weight
3. The name of the vessel or carrier
4. The port of loading
5. The port of discharge
6. The country or origin of the shipment
7. The name and address of each importer or consignee and the name and address of the shipper unless the importer or consignee has requested confidential treatment of such information.

Customs has developed an Automated Manifest System (AMS) as an integral module of the ACS. The manifest module is, in essence, both an imported merchandise inventory control system and a cargo release notification system. By comparing information provided in the manifest with automated Customs entry data and inspection guidelines, Customs is able to make informed decisions with respect to the allocation of resources for the inspection of merchandise.

Forty percent of all sea carriage bills of lading, involving thirteen water carriers, are included in AMS. The Customs Service started with sea carriage rather than air carriage because timing is less critical, and ship manifests therefore put less pressure on the system for quick turn around. On the other hand, air bills of lading already have unique manifest and bill of lading numbers, and it is expected that air carrier manifests can be added to the AMS system without too much difficulty.

Automated manifest data may be transmitted to Customs by one of two methods. Carriers may transmit data directly to the AMS with their own compatible automated system. Alternatively, carriers may use the computer facilities of port authorities ("PAs") or service centers which have established interface capability with Customs. After receiving and analyzing the data, Customs makes its decision with respect to inspection and release of the merchandise. Once the merchandise is authorized for release, the carrier, service center or PA which transmitted the data receives a message from the system informing it of that fact. Thus each user can track the status of cargo for which it transmitted data.

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[105] 19 U.S.C. §1431.

Customs Regulations[106] permit importers or consignees to request confidential treatment of their names and addresses and that of their shippers. To date, Customs Headquarters has on file approximately 1,100 requests for confidential treatment.

The Customs Regulations[107] also provide that accredited representatives of the press, including newspapers, commercial magazines, trade journals, and similar publications shall be permitted to examine vessel manifests and to copy therefrom manifest information made public by statute. Members of the general public are not given direct disclosure of the documents but may obtain information from manifests upon request. Importers or agents are permitted to examine manifests in which they have an interest as principal or agent.

At present, Customs compiles a list of those importers and consignees who have requested confidentiality. The list is updated on a weekly basis, and is provided to all Customs offices nationwide. The list is also provided to certain commercial trade publications such as King Publishing Co. and the Journal of Commerce. These trade publications publish the manifest data, taking steps to make certain that the names and addresses of those who have requested confidentiality are deleted.

When ACS was in the planning stages, Customs encouraged the international trade community to participate in its development in order to share in the benefits that could accrue through the more efficient processing of commercial transactions. Among those who expressed a significant interest in ACS (particularly in AMS) were port authorities ("PAs"). PAs viewed AMS as a means of streamlining their involvement in the processing of cargo as well as attracting new business to their ports. Customs viewed PAs as a potential conduit for the acquisition of AMS data from non-automated carriers who were interested but otherwise lacked the capability to transmit their manifest data electronically. PAs were informed that if they were willing to assume this role they would be eligible to receive all automated manifest data for those manifests which Customs receives for vessels calling in their ports regardless of whether the carrier used the PA to transmit its data.

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[106] 19 CFR §103.14(d).

[107] 19 CFR §103.14(c).

In addition to receiving manifest data, beginning in June, 1988, eligible PAs will be entitled to receive release data which conveys the status of the cargo being processed through their ports. Release data would be provided from the manifest when an automated manifest is filed at the port. When no automated manifest is filed, PAs would receive release data obtained from entry documents for all formal entries made in the port provided that the entry filer has given his written consent.

Finally, eligible PAs would receive manifest data which is transmitted through AMS with respect to all cargo which moves master in bond to their ports. For example, when a carrier files an automated manifest for cargo from a vessel which calls at Seattle but will move via master in bond procedures to Boston, the Massachusetts Port Authority will receive an extract of the manifest filed at Seattle. This will enable Massport to have a more accurate account of cargo in transit to it.

These data are to be provided to PAs via on-line access. Customs recognizes that the value of the data to the PAs as a basis for cargo release services is tied to the data being provided in an expeditious manner. Accordingly, Customs intends to provide these data directly to the PAs' automated systems as soon as is operationally feasible.

In order to be eligible to receive automated manifest data, release data, and the master in bond data, a PA must develop the full technical capacity to transmit as well as to receive AMS data. This means that the PA must demonstrate to Customs' satisfaction that it possesses all the necessary facilities to be capable of providing full AMS services to any interested carrier. Customs recognizes that the development of this capacity does not guarantee that carriers will use PAs' services. One difficulty has been that many carriers do not use a unique bill of lading number in their business operations. Such a unique identifier is necessary in order for AMS to operate. A proposed amendment to the Customs Regulations mandating the use of a unique bill of lading identifier may eliminate this obstacle to participation in AMS by carriers.[108]

Customs has not established a minimum number of manifests to be transmitted in order for a PA to be eligible to participate. Customs will, however, condition continued access to information on efforts by PAs to acquire customers for this service. If a PA declines to provide AMS services when requested by a carrier, or does not make efforts to obtain participation by carriers, Customs will reevaluate its decision to provide access.

Customs intends to make available to the public, beginning in 1988, weekly magnetic tapes containing certain manifest data captured by AMS nationwide. This tape would be available at a price based on the cost of producing it, and would contain the same data elements that are in the manifest file to be provided to the PAs.

Manifest data to be provided to the PAs and to the public will be sanitized by removing the names and addresses of those importers/consignees and that of their shippers when confidentiality has been requested. Customs has developed a computer program that automatically deletes the names and addresses of these requesters when manifests containing their name are transmitted through AMS.

Port authorities have joined AMS only slowly, having difficulties with contractor efforts to develop necessary systems and pleading for more Customs Service technical support with regard to systems development. Generally, the Customs Service has taken the position that importers bear the responsibility for acquiring and presenting the required information to the Customs Service, and that the Customs Service has no duty to provide assistance in this process. This allocation of responsibility pleases the broker community.

AMS and ABI communicate with each other, facilitating accounting for unladed cargo, but only for that portion that is in both AMS and ABI. The link between the two systems permits the Service to give ABI participants advance cargo release information, something the brokers wanted very much. Participating port authorities get everything that a participating broker gets.

3 *Line Release System*

The Line Release System module initially was developed for use at

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[108] *See* 52 FED.REG. at 46602 (Dec. 9, 1987).

Canadian and Mexican border locations to expedite the tracking and release of repetitive, low risk shipments. The Line Release System works through personal computers in facilities used by inspectors. Brokers qualifying for participation in the system supply advance data on the nature of a series of repetitive shipments. The brokers supply bar-coded cards to truck drivers. When the shipment enters the country, the inspector scans the bar code with a wand connected to the personal computer, and the PC matches the bar code number with the data previously provided to the central Customs Service computer by the broker. The result is quicker release of shipments, and the availability of additional descriptive information to the inspector.

4 *Issues*

The Automatic Commercial System presents the same generic issues as other electronic programs discussed in this report, in different relative emphasis. The Customs Service mission is a tax collection and law enforcement mission, far different from the SEC's and USPTO's information dissemination missions. Information presently collected by the Customs Service is highly structured. This makes it easier to address compatibility and filing format questions and also makes it easier to design a sophisticated database. Because historically there has not been a large market for information collected by the Customs Service, virtually no one is in the business of disseminating it. So Customs Service issues are driven more by the acquisition side than by the release side.

Paper information filed presently with the Customs Service is highly structured, and it has not been difficult to translate existing data structures designed for a paper system to an electronic environment. The Service considered the EDI standard[109] but rejected it for the ABI system because it offered few advantages and requires more overhead than the eventual 80 character record standard ultimately adopted by the Service. For AMS, however, the Customs commissioner made an international agreement to permit EDI formats to be used, and AMS users have the option to supply information in the EDI formats. If current plans materialize to add invoice information to ACS, the EDI standard issue undoubtedly will resurface because of the likelihood that much of the shipper/importer/consignee community presently prepares invoices in an EDI format. Customs also has promoted use of the Harmonized (Commodity) Code, used by many trading partners, and potentially useful in automating ocean shipping tariffs as well as customs documents.

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[109] *See* §VI(A)(2)(a).

A transitional problem exists: only part of the data is acquired electronically. The remainder must be keyed by government personnel or contractors. As an interim measure, the Service hopes to agree with the Census Bureau to use Census data center personnel to key paper records for inclusion in the ABI database. The Service has a close working relationship with Census because much statistical information is collected initially by Customs, and ABI and AMS have been used to facilitate the initial editing of these statistical data for delivery in electronic form to the Census Bureau.

The Customs Service has faced little opposition from the Congress,[110] from OMB, or from its constituencies. ACS is operational, and the significant implementation issues relate to how additional brokers and port authorities can be induced to participate in order to get all of the inspection, release, and collections data in the electronic base.

Two user charge issues arise with respect to ACS. The Service charges $500 per copy of a tape of the ABI data to any non-ABI participant. The same tape is available free to ABI participants, and updates are provided periodically via participant mailboxes. No updates are provided to non-ABI participants: rather they can buy a new copy of the entire tape for another $500. The Service has considered charging a fee to brokers who file on paper, increasing incentives to participate in ABI. This idea has not proceeded beyond the discussion status, however.

The big issue with the Customs Service system is electronic FOIA.[111] Shall everyone have equal access, or should the Customs Service be permitted to give preferred access to certain consumers? At present, the Customs Service envisions giving port authorities exclusive use of manifest information for fifteen days before it is released to the general public. This position is motivated by the need to create incentives for port authorities to participate in the program.

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[110] Apparently, however, the staff of some Congressional committees is dissatisfied with Customs Service lack of response to Congressional inquiries about the accessibility of data in ACS.

[111] The Customs Service informed the author that it does not agree with the following characterization of the issue.

Filers have been induced to support electronic filing because they get access in electronic form to data that is of interest to them. Port authorities must spend approximately $100,000 for hardware necessary to file electronically, but they have been relatively eager to do so because by participating, they get access to the filings in electronic forms.

Though Customs has the statutory authority to require brokers to file electronically, ABI operates on a voluntary basis at the present time. The voluntary approach necessitates creating incentives for brokers to participate. These incentives depend upon Customs being able to restrict electronic release of ABI data to ABI participants. Otherwise, most of the benefits of participation would be available to non-participants. Protecting these incentives depends upon Customs being able to sustain its interpretation of FOIA. In particular, Customs must defend the position that the FOIA does not require access in electronic form when such access necessitates programming or use of agency software to retrieve the requested information.[112] Customs also must sustain the same position and the same economic imperative, based on a position that access is not required when exempt or Privacy-Act-protected information is intermingled with disclosable information and the two can be separated only through programming or agency software. Some brokers are apparently reselling ABI information, but the Service is not concerned with this because possible resale increases the value to ABI participants, thereby increasing incentives to participate.

USCS's desire to create incentives for voluntary participation in electronic acquisition is not inappropriate. But the interpretations of the FOIA necessary to protect the incentives are not consistent with an interpretation of the FOIA that would cover electronic information across the board. To some extent, resolution of the cost-of-programming issue[113] provides the opportunity for some reconciliation of the conflict.

D. Federal Energy Regulatory Commission, U. S. Department of Energy

1. *Introduction*

The Federal Energy Regulatory Commission ("FERC") is an independent regulatory commission within the Department of

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[112] *See* §V(F)(4)(a) for a broader discussion of these FOIA issues.

[113] *See* §V(F)(4)(a)(iii).

Energy.[114] FERC has authority to review and approve rates for electric energy and natural gas, and to perform other economic regulatory functions relating to sale and distribution of energy.[115]

2 *Commission Issuance Posting System (CIPS)*

CIPS is a bulletin board service that provides timely disclosure of the latest FERC issuances, press releases, the Commission agenda, and a daily listing of all filings made at the Commission. Access to this service is free of charge to users. Each user is permitted up to 60 minutes connect time for each call. CIPS provides two capabilities - reading bulletins and downloading files. The CIPS maintains an extensive online help system. CIPS does not have functions available for sending messages, receiving messages or uploading files. This service is available 23 hours every day.[116]

Beginning May 25, 1988, the daily list of filings made at the Commission with the assigned docket numbers have been available on CIPS. The daily list remains on the CIPS for two weeks. The daily list is posted on CIPS by 9:00 a.m. the day following the distribution date.

CIPS has online the full text of the FERC daily issuances and press releases at approximately 10:00 a.m. and 3:00 p.m. on normal business days. FERC issuances are the formal documents the Commission issues such as proposed, interim, and final rules,[117] initial decisions of Administrative Law Judges, opinions, notices and a variety of orders and other issuances.

The Commission agenda, which is a list of actions scheduled for a public Commission meeting, is available on the CIPS approximately seven days prior to a scheduled public Commission meeting. CIPS also has available a daily listing of all filings made at the Commission. The list consists of the date of the filing, the name of the company who made the filing and the assigned docket number. This list is available on the CIPS by 9:00 a.m. one to two days after the filing date.

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[114] 42 U.S.C. §7171 (1982).

[115] 42 U.S.C. §7172 (1982).

[116] It is not available between 8:00 a.m. and 9:00 a.m., Monday through Friday.

[117] *See, e.g.* 53 FED.REG. 32035 (Aug. 23, 1988) (final rule, referring public to CIPS for machine-readable text).

All information remains on the CIPS for 10 working days. The text of the daily issuances, the press releases, the Commission Agenda and the listing of filings can be downloaded, or searched by date, document number, or text string such as company name. Files can be downloaded in ASCII format or using the common microcomputer error-checking protocols Xmodem, Xmodem/CRC, Kermit, and Ymodem.

3 *Mandatory Electronic Filing*

The Federal Energy Regulatory Commission has issued a final order[118] requiring natural gas companies to use an electronic medium when filing certain rate filings, certificate and abandonment applications and FERC forms.

The order requires filing on magnetic tape, microcomputer diskette, or magnetic cartridge, and for a transitional period, filing paper copies of the material filed electronically. Pleadings and applications also must be filed electronically.[119]

Waivers from the electronic filing requirement are available for companies showing (1) lack of computer capability to meet the filing requirements, and (2) severe economic hardship if the company were to acquire the capability.[120]

Requests for protection of privileged information can be filed by designating the privileged information on the magnetic filing.[121]

FERC provides software for printing hard copies of magnetic filings and to permit filers to apply FERC error checking criteria to their data.

The order specifies filing formats in some detail, requires filings in ASCII, and provides for a technical implementation conference in September, 1988.[122]

Filings and FERC orders are available to the public via the

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[118] Order No. 493, 53 FED.REG. 15023 (Apr. 27, 1988), as amended, 53 FED.REG. 30027 (Aug. 10, 1988).

[119] 53 FED.REG. at 15030.

[120] 53 Fed.Reg. at 15032, 53 FED.REG. at 30029.

[121] 53 FED.REG. at 15032; 53 FED.REG. at 30030.

[122] *See* 53 FED.REG. 32891 (Aug. 29, 1988) (agenda for implementation conference, and staff answers to technical questions).

Commission Issuance Posting System (CIPS), described in the preceding section.

4 *Issues*

The FERC systems are the most mature electronic acquisition and release systems oriented primarily toward APA regulatory dockets. They apparently have engendered little controversy. CIPS is a good example of an effective way to publish regulatory information electronically. The author has accessed CIPS and finds it easy to use and up to date.

E. Federal Maritime Commission Electronic Tariffs

The Federal Maritime Commission ("FMC") is authorized by the Shipping Acts of 1916 and 1984[123] to require the filing of tariffs, which establish legal rates binding on carriers and shippers.

Under the present, non-automated tariff system, FMC receives in excess of 700,000 pages of tariff filings or revisions per year, containing some 8-10 rates per page, from about 1500 filers. The number of shippers potentially wanting access to the tariffs is, in theory, unlimited, because anyone who deals in tangible products might consider water transportation of those products. It is clear that the portion of the shipper/consignee community interested in ocean tariffs is growing, as trade becomes more international and producers become more sensitive to the impact of transportation costs on their competitive positions.

About 30% of tariffs are converted into paper form from an original electronic form. The principal firms serving as filing intermediaries also provide shippers with software and hardware to prepare tariffs and tariff amendments electronically, so they can be filed through the provider of the hardware and software. Transax/RATES [Journal of Commerce] has a database containing the full text of most of the FMC tariff file, to which it sells disclosure.[124] The Transax/RATES database is oriented to the tariff page format presently used by the FMC for paper tariffs, and not to a structured database for individual tariffs.

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[123] 46 U.S.C.A. App. §800-848; 1701-1719 (West 1988 Supp.).

[124] *The Electronic Collection and Dissemination of Information by Federal Agencies: A Policy Overview*, H.R. Rep. 99-560, 99th Cong., 2d Sess. (1986) [hereinafter "House Policy Report"] 46-47.

1 AFTI

A draft RFP for an Automated Tariff Filing and Information System (ATFI) was released in the Spring of 1988. The FMC issued a Notice of Inquiry on Tariff Automation in December, 1987,[125] received comments, and published its response on April 15, 1988.[126] The System, which will accommodate slightly more than 3 gigabytes of data in FY86, growing to 4.25 gigabytes in FY90, a size characterized by the FMC concept development contractor as "large but not unmanageable,"[127] embodies a database philosophy instead of the current text-page philosophy, permitting individual tariffs to be retrieved electronically. The FMC will release tapes of the entire database in a "flat file format" to anyone at marginal cost. Tariffs will be filed via modem/telecommunications links. They will be screened automatically to reject filings failing to meet certain criteria respecting form and timeliness. Other tariffs will be selected based on Commission staff generated criteria for substantive review and possible suspension or modification by the Commission. Public disclosure will be provided through terminals in the FMC's reading rooms. The FMC also contemplates providing public dialup links to the raw data, but this has been opposed by some members of the information industry, who apparently oppose disclosure even to a filer of its own tariffs. The availability of tariff data in an electronic database form should materially reduce the data preparation costs of present companies who sell electronic access to tariffs.

ATFI capabilities include:[128]:

A. Tariff Filing

1. Electronically transmit and accept tariff filings
2. Provide fault tolerant filing
3. Assure compatibility with existing systems

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[125] 52 FED.REG. 48504 (Dec. 22, 1987).

[126] Federal Maritime Commission, Report on Tariff Automation Inquiry (served Apr. 15, 1988) [hereinafter "Apr. 15 FMC Report"].

[127] Deliverable No.6, Aug. 20, 1986 at A-2

[128] Feasibility Study Final Report at III-1 to III-5 (Oct. 28, 1986).

B. Tariff processing

1. Route tariff filings automatically
2. Perform computer-assisted conformity-checking of tariff filings
3. Generate FMC communications automatically
4. Provide tickler capability
5. Provide a tracking function
6. Compile workload statistics

C. Retrieval and analysis of tariff information

1. Allow FMC to retrieve current and historical tariff information by different keys, including type of tariff, carrier, conference, terminal operator, shipper, commodity, quantity and volume, origin and destination, trade and subtrade, and date of shipment
2. Allow FMC to retrieve current and historical tariff information in different formats
3. Provide tools to enable FMC to analyze tariff data
4. Enable the maritime industry and public to perform basic tariff retrievals
5. Provide easy access to bulk tariff data

2 *Issues*

Several issues have arisen in connection with ATFI system concepts. The first involves creating a monopoly, or significant restrictions, over information sale. The constituencies and FMC have rejected this. In the meeting of the advisory committee which reviewed the contractor feasibility report, some segments of the filing community expressed the view that filers add significant value or intellectual capital to their tariffs, and expressed concern about the FMC making that work product available in a form that could be sold by third parties.[129]

The second issue concerns tariff filing fees, which are not presently charged, but which have been promoted by OMB.

The third issue concerns the possibility that the Congress may eliminate the ocean shipping tariff system altogether when sunset review of FMC comes up in 1989. The possibility of this has caused some constituencies to moderate their enthusiasm for a major new tariff automation program, preferring instead an interim cooperative effort between the FMC and existing information vendors.[130]

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[129] Comments of Ron Gottschall, Transpacific Westbound Rate Agreement, Minutes of Advisory Committee Meeting, Nov. 19, 1986 at 12-13.

The fourth issue involves format standardization—what has come to be called the "data tagging" question in connection with EDGAR.[131] Though superficially, tariff information might seem to be inherently structured, in fact tariffs are filed on pages, with a significant amount of textual explanation and limitations appended to the numerical rate information. Accordingly, to develop acquisition formats limited to machine processable data elements is a much greater departure from existing practice than is involved in automating tax returns or customs entry information. The change from present practice is less, however, than is involved in forcing corporate filings into a completely structured format or in forcing patent or trademark applications into a completely structured format.

Existing vendors questioned the decision to embrace an entirely new format standard premised on a relational database architecture, apparently preferring to preserve the value of capital already invested by them and some large shippers in existing formats.[132] The FMC plans to use a data structure standard developed by the Transportation Data Coordinating Committee ("TDCC"), under the umbrella of the X.12 EDI standard development effort.[133] The TDCC adopted a Transportation Line Item format with relatively little difficulty, because of the commitment of the TDCC's members to the need for a standard, the fact that tariff information is inherently structured, though filed in a textual format, and the flexibility of the EDI process, which basically permits "special interest" (industry) groups to propose standards meeting their needs, standards frequently already in use commercially by members of the industry which prima facie are adopted as part of the EDI standard.

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[130] Comments of W.E.Reinka, Zephyr Container Line., Minutes of Advisory Committee Meeting, Nov. 19, 1986 at 21.

[131] *See* §II(B)(3) and §VI(A)(2)(c) (data tagging in general), §III(A)(5) (SEC data tagging issue).

[132] *Id*. at 25; Dec. 1, 1986 letter from David Peyton to John Robert Ewers, attached to Nov. 16 Advisory Committee meeting minutes; April 15 FMC Report, *supra* note 128 at 9 (Inter-American Freight Conference), 15 (Information Industry Association), 18 (Transax) (favoring continuation of page-oriented approach rather than database approach, at least as transition strategy). But see *id*. at 10 (Transpacific Westbound Rate Agreement) (favoring database approach).

[133] *See* §VI(A)(2)(a) regarding X.12 standard.

The fifth, and most significant, issue over ATFI relates to interactive public disclosure of ATFI data. The Commission reviewed the House Policy Report[134] and agreed to follow its principles to the maximum extent feasible. The Commission has committed itself not to "perform value-added services to the public in competition with third-party vendors."[135] But the Commission also has reiterated its intention to provide a "remote retrieval" feature, permitting the public to dial into the ATFI system by modem and obtain a carrier's rate on a particular commodity by trade.[136] Positions of constituency groups are sharply split, with major information consumers favoring remote access,[137] and existing information vendors opposing it.[138]

In its response to comments on its Notice of Inquiry,[139] the Commission observed that remote electronic access to ATFI is "access" and not "dissemination" under the OMB nomenclature.[140] When a member of the public dials up via modem, the member of the public, not the agency, is taking the initiative to cause release of the information.[141] Remote retrieval "merely extends the public reference room concept by allowing remote electronic access to one tariff at a time by any member of the public, wherever situated." "Can the Commission legally allow the public doing business in the Washington, DC area to have on-line access, while everyone else has to submit an FOIA request in writing? If the remote retrieval feature would compete with commercial firms, then why not the public reference room?"[142] OMB apparently disagrees with this FMC interpretation of OMB Circular A-130, but discussions between OMB and FMC may resolve the disagreement.

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[134] *See* House Policy Report, *supra* note 124,

[135] "FMC Issues Report on Tariff Automation Inquiry" (press release NR 88-16, accompanying FMC Report on Tariff Automation Inquiry, Apr. 15, 1988).

[136] Press Release NR 88-16, at 2.

[137] *See* April 15 FMC Report, *supra* note 128, at 9 (TDCC), 12 (Pacific Coast Council of Customs Brokers and Freight Forwarders Ass'n, Inc.), 13 (Warner Lambert Co.). The Department of Agriculture, representing commercial shippers of farm products, also favors remote access.

[138] *See* April 15 FMC Report, *supra* note 128, at 8 (Rep. English), 10 (Transpacific Westbound Rate Agreement), 15 (Information Industry Ass'n), 19 (Transax).

[139] *See generally* April 15 FMC Report, *supra* note 128,, at 22-48.

[140] *See* §VI(C) explaining why it is difficult technologically to draw a distinction between providing access and disseminating information.

ATFI presents some issues shared by other programs and some distinct issues of its own. As with other systems, tariff filing and release is highly automated, with the automation services performed by third party enterprises. As with other systems, existing electronic information vendors challenge the need for a new government initiative relating to release. But tariff information is much more volatile than financial information filed with the SEC or patent data. Therefore, the likelihood is low that periodic distribution of tariff data via electronic media would be satisfactory. On line disclosure is almost certainly needed. Private companies already offer both collection and dissemination services respecting FMC's ocean tariffs. So the FMC was confronted with less need to develop electronic data systems from scratch, but it also has less to offer by way of a new product with significant market value.[143] It should be noted however, that existing private-sector information products containing FMC tariff information are oriented to the tariff page format presently used by the FMC for paper tariffs, and not to a structured database for individual tariffs. The structured database proposed by the FMC permits more flexibility in tariff updating, retrieval, and analysis.

disclosure to FMC tariff information also has a special legal character. Only the FMC can certify that a rate in a tariff has been filed properly and is in effect. Such "certification" is required in private litigation over rates. In this sense, disclosure to FMC tariffs is necessary, and it may be impermissible for FMC to recover its full costs for providing the information in electronic form. But if the information is available to some people at less than full cost, it may not be permissible to charge higher prices to other requesters.

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[141] April 15 FMC Report, *supra* note 128, at 35.

[142] April 15 FMC Report, *supra* note 128,, at 44.

[143] House Policy Report, *supra* note 124, at 47.

In the near term, ATFI represents the most likely battleground for resolution of policy issues with broad implications for the respective roles of public and private sectors in electronic information dissemination.

F. Patent and Trademark Office

The United States Patent and Trademark Office ("USPTO"), an agency of the Department of Commerce, processes and examines over 200,000 patent and trademark applications annually. Patent applications are preprocessed before being submitted to examiners.[144] Patent examination requires comparison of patent application subject matter to a large body of technological information to determine that the proposed inventions are new and not obvious to someone knowledgeable in the field. Examiner search files are arranged by subject matter and contain some 24 million documents. The files are organized into 395 classes and 115,220 distinct subclasses.[145], Patent information is disseminated to the public in various ways, for example through the weekly *Official Gazette* prepared by the GPO (5,000 copies weekly), through public patent search files involving the addition of about 800,000 documents annually,[146], and through bibliographic and full text files made searchable by commercial vendors.

Trademark examination involves comparing marks shown in new applications to over 700,000 registered and pending trademarks to ensure that they are not confusingly similar.[147], Over 70,000 trademark applications are filed annually. After pre-processing, trademark applications are examined for compliance with applicable statutory provisions covering registration and, if accepted, are published in the *Official Gazette* to provide an opportunity for public objection to registration.

USPTO has adopted an Automation Master Plan under a mandate

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144 United States Patent and Trademark Office, Automation Master Plan, Edition 3 at C-1 to C-2 (April, 1987) [hereinafter "USPTO Master Plan"].

145 USPTO Master Plan, *supra* note 144, at C-3.

146 USPTO Master Plan, *supra* note 144, at C-4 to C-5.

147 USPTO Master Plan, *supra* note 144, at C-1.

from the Congress contained in §9 of Public Law 96-517.[148] USPTO released the third edition of its Automation Master Plan in August, 1987, drawing upon comments on earlier editions of the plan and on implementation experience. In addition, Public Law 99-607 obligates USPTO to report major automation deployment decisions to the Congress 90 days in advance.

Trademark processing automation has advanced further than patent processing automation. All trademark examining attorneys use an automated trademark search system, T-Search, during the examination process to search USPTO records for registered and pending trademarks which may, if the newly filed mark is allowed to register, result in a likelihood of confusion. USPTO publishes the *Trademark Official Gazette* using data maintained on its computers for photocomposition. The electronic patent database will be larger and the examining process using automated systems is more complex. USPTO has scheduled patent automation to permit lessons learned from trademark automation to be applied to patent automation, though the two systems are not similar in detail.

1 *Patent Automation*

The Automated Patent System (APS) has four main levels of capability: full text search; all electronic search; public search room and office automation; and electronic file wrapper.[149] PALM is a separate internal inventory management system, which has been operational since 1972. The ultimate size of the APS database is estimated at 22 trillion bytes,[150] growing to 30 trillion bytes by the Year 2000.

Presently the full text of some 900,000 patent files for patents granted since 1975 is available online to all patent examining groups. Patents from 1971 to 1974 are being added in 1989. Foreign patent (English) abstracts for Japanese and Chinese were available in 1988, with coverage being expanded to European patents in 1989. Search aids, such as U.S. and international classification manuals, will be added in the same time frame. All patent files for patents granted since 1790 are being scanned to produce digital images[151] of each page, graphical as well as text data, in CCITT Group 4 compatible formats.[152] Conversion of 36 million pages of existing U.S. patents into digital image form began in the first quarter of 1987 and is largely complete. These files will be written to optical media.[153] A future part of the conversion of existing patent records relates to adding photocomposition control codes and tags permitting graphical images to be linked to text.[154] Production testing of APS OC2 has begun[155] with a test bed for patent examining group 220.[156] Beginning in 1987, USPTO began to exchange text and image electronic patent databases with the European Patent Office and the Japanese Patent Office.

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[148] 94 Stat. 3015.

[149] USPTO Master Plan, *supra* note 144, at I-22.

[150] USPTO Master Plan, *supra* note 144, at II-13.

USPTO expects, by FY 1989, to begin deploying more sophisticated electronic work stations to permit searching of both electronic text and drawing files, ultimately replacing text-only terminals installed in 1987. The pace of deployment is limited by the need to rewire existing examiner buildings for the Ethernet network.

In the future, USPTO plans to shift responsibility for fulfilling public orders for patent copies (presently 3.2 million copies per year) from an existing microform-based reproduction system to APS.[157] Ultimately, USPTO hopes to expand APS to afford an Electronic File Wrapper (EFW) capability so that an entire patent application can be created and maintained in electronic form.[158] Deployment of the EFW capability is not planned before 1990.

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[151] The cost of producing digitized images of pages is about $1.50 per page, compared with about $35/page to key the character data. Digitized page images can be searched only by patent number and classification. Image files can be displayed; keyed data can be text searched and displayed.

[152] USPTO Master Plan, *supra* note 144, at II-29.

[153] USPTO Master Plan, *supra* note 144, at I-10.

[154] USPTO Master Plan, *supra* note 144, at I-12.

[155] A detailed milestone of APS plans is provided in USPTO Master Plan, *supra* note 144, at II-48.

[156] Group 220 is the Special Laws Administration group in the Electrical Examining area.

[157] USPTO Master Plan, *supra* note 144, at I-1

[158] USPTO Master Plan, *supra* note 144, at I-13 - I-17

As a part of EFW, USPTO also intends to develop concepts for filing of patent applications and amendments via direct electronic transmission from applicants or their attorneys.[159] Standards must be set for filing of graphical information.[160] Electronic filing will not become a large-scale reality until EFW capability is in place.[161]

A limited public evaluation of the APS text and image searching capabilities was conducted from January, 1988 to June, 1988. Participants in the evaluation were selected by the USPTO, and participated in a 12-16 hour training course before using the APS search system in the USPTO Arlington, VA facilities.[162]

2 *Trademark Automation*

The Automated Trademark System had its origins in 1983.[163] In 1983, USPTO began a series of non-cash exchange agreements with private companies. Under these agreements USPTO provided copies of trademark documents. The companies converted the documents to machine readable form and gave USPTO a copy of the electronic database containing text and images of trademarks and applications for trademarks. USPTO entered into the exchange agreements because funds were not available at that time to pay for computerizing the trademark database, while proceeding with other activities required to automate trademarks.[164] USPTO agreed to release to the public only printed paper copies of the converted data "in a style and format which will prevent or discourage conversion to a computer processable form."[165] USPTO also agreed to limit public use of electronic search techniques to those which were "comparable and equivalent" to manual techniques.[166] A House Committee subsequently observed that all of the data to which USPTO agreed to restrict disclosure is in the public domain. In effect USPTO agreed to impose disclosure restrictions and costs on others in exchange for free services.[167] This led the House Committee to criticize in general the dangers of non-cash arrangements.[168]

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[159] USPTO Master Plan, *supra* note 144, at II-29.

[160] USPTO Master Plan, *supra* note 144, at II-30

[161] USPTO Master Plan, *supra* note 144, at II-30.

[162] 1085 Official Gazette - Patents 6 (Dec. 1, 1987).

[163] A detailed milestone chart for ATS begins in USPTO Master Plan, *supra* note 144, at IV-32.

[164] *The Electronic Collection and Dissemination of Information by Federal Agencies: A Policy Overview*, H.R. Rep. 99-560, 99th Cong., 2d Sess. (1986) [hereinafter "House Policy Report"] at 47. The report was based on a study made by the Subcommittee on Government Information, Justice and Agriculture Subcommittee, chaired by Representative Glenn English of Oklahoma. Subcommittee staff director Robert Gellman wrote the report.

Trademark automation presently includes two systems: T-Search and TRAM. T-Search includes compressed digitized images stored on magnetic disk with a resolution of 240-300 dpi, and text stored in ASCII format. T-Search has been used by all trademark examining attorneys for word mark searching since August, 1986, and for word and image (design) searching since January 1988. TRAM contains selected text data for all active, and a substantial number of inactive, pending and registered trademarks in the USPTO, and also includes the prosecution history and some aspects of ex parte and inter partes litigation for these records. TRAM provides a limited public search capability. TRAM is the primary trademarks database, and magnetic tapes extracted from TRAM drive the typesetters used for the *Official Gazette* and is also used to update the T-Search text database. The TRAM database is updated on a real time basis utilizing online text editing and other real time input devices.

3 *Issues*

USPTO automation has engendered significant controversy. Concerns are expressed as to whether the systems will work.[169] Major litigation is pending regarding USPTO's electronic release obligations.[170]

a. Electronic acquisition

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[165] House Policy Report *supra* note 124, at 48.

[166] House Policy Report *supra* note 124, at 48.

[167] House Policy Report *supra* note 124, at 50.

[168] House Policy Report *supra* note 124, at 50-52.

[169] *See Patent Files Vs. Computer Age: Automation Effort Running Years Late Amid Cost Overrun*, NEW YORK TIMES, Sep. 12, 1988, at D1.

[170] *See* §III(F)(3)(b).

USPTO anticipates that its automation program ultimately will provide for a "paperless" patent and trademark examining system, with applications filed, processed and disseminated electronically. Realizing the goal is dependent upon resolution of issues impacting electronic filing. The total community potentially affected by mandatory electronic filing numbers about 10,000 registered patent attorneys, as well as trademark attorneys, public searchers, and representatives from corporations, libraries and universities. Electronic acquisition is not yet a reality for two somewhat different reasons.

Electronic patent filing, to be most useful, must include the capability of filing structured text and images. For such capability to be widely available to practitioners, standards must be developed. USPTO is participating in a trilateral effort with Japanese and European intellectual property authorities to develop standards for text format, standard data elements and image representation. Trilateral standards have been developed for patent documents but not for applications. Agreement was reached in 1988 on the CCITT Group 4 Facsimile standard for image representation.[171] Affordable scanner technology embodying the CCITT standards is widely available to practitioners. The trilateral group is meeting several times a year to reach agreement on text format and data element standards.

The timing of electronic filing of trademark applications is somewhat uncertain, in part because of the possibility that Congress could enact legislation that would change the underlying legal concept of trademark protection, permitting trademarks to be registered in anticipation of use, rather than only when commercial use can be demonstrated. If such legislation is enacted, the type of information to be submitted with trademark applications would change significantly.

b. Electronic release

An important part of the USPTO mission is to disseminate information. Since June, 1984, USPTO has made available to the public tapes of portions of its patent and trademark databases for "fair market value." The patent full text file was available at a price of about $77,000 per year for 52 tapes. Under a revised information dissemination guideline policy implemented in December,[172] USPTO charges only the marginal cost of duplicating tapes, resulting in a price of about $18,000 per year for the full patent text database. There are only a few dozen subscribers for the database, a number that did not change with the price reduction. USPTO also would duplicate and make available the patent database in optical disk form on request, but has received no requests.

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[171] This provides a data compression ratio of about 20-to-1. Data compression is important to reduce demands on telecommunications links and storage media for the very large quantity of data required to represent images. *See* §II(B)(3) regarding computer representation of images.

Formulating a policy for public access to the automated search systems has been complicated by conflicting pressures from OMB, the Congress and interest groups. Existing commercial vendors of electronic patent and trademark data[173] vigorously opposed not only wide public disclosure but also in-house automation. Commercial vendors continue to oppose on-line public availability, even though such availability would involve little if any added value by USPTO beyond that developed for its internal needs. The economic barriers to entry are enormous, raising questions about the appropriateness of any policy that assumes a competitive private market for information dissemination.[174] The economic motive for opposing USPTO electronic publishing is apparent from a price comparison. The price of access to Mead's LEXPAT database currently is $325/hour. USPTO estimates a price of $75/hour for public access to its automated search system.

OMB prefers user fees for public disclosure, but the Congress mandated, in legislation[175] expiring in the Fall of 1988, that no user fees be charged for public access. The community potentially desiring access is composed primarily of 300 or so patent and trademark search firms located in or near Washington, and the much larger community of 10,000 registered patent practitioners as well as trademark attorneys, public searchers, corporations, libraries and universities located around the country. The Washington-area search firms may fear inexpensive dialup links because that could permit practitioners to bypass specialized local search services. Opponents of wide public access understand that low or no user fees probably mean no public access because of competing demands for public funds. Interests desiring wider public access probably understand the same thing. Accordingly, there is a tendency for political role reversal to occur, present vendors siding with Congress in favor of low or no user fees, and the potential information consumers siding with OMB in favor of user fees. USPTO is attempting to split the difference, by proposing a policy under which USPTO would provide direct public disclosure at its headquarters and through high-speed data links to some 63 Patent Depository Libraries around the country. Other public disclosure would be channeled through commercial vendors unless the vendor declines to provide a particular kind of service, in which case USPTO would consider providing it directly.[176]

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[172] 52 FED.REG. 31442 (Aug. 20, 1987). A comprehensive review of USPTO electronic information policy and pricing issues is underway. 53 FED.REG. 23677 (Jun. 23, 1988).

[173] Mead Data Central has the most complete database, "LEXPAT."

[174] *See* §V(F)(1) for a more general discussion of the economics of information.

[175] P.L. 99-207, authorizing appropriations through September 30, 1988.

USPTO presently is involved in litigation brought by International Computaprint Corp. over USPTO's refusal to provide access under the FOIA to its data in electronic form.[177] *Computaprint* is a good example of the FOIA's role in shaping agency policies regarding competition with the private sector, discussed in §V(F)(4)(a)(iv).

In *International Computaprint Corp. v. U. S. Department of Commerce*,[178] Computaprint challenged USPTO's denial of an FOIA request for magnetic tapes containing computerized database of public trademark information. USPTO denied the request, in part on the grounds that the requested records already were available on computer terminals in USPTO's public reference room, and in part on the grounds that the requested magnetic media constituted USPTO's system for delivering information, not disclosable as an FOIA "record."[179] Computaprint challenged the adequacy of public reference room terminal disclosure to satisfy its request, asserting that it would take eight years and more than $500,000 to extract the information from the terminals.[180] Several Computaprint competitors intervened in the district court action, arguing that USPTO should not release the requested information. Later, Computaprint filed a "praecipe"[181] stipulating that it sought only public trademark information in computer-readable or computer-output form, and not any proprietary information developed by intervenors constituting a trade secret.

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[176] A Subcommittee of the AIPLA , "The Group 220 Subcommittee" has undertaken a study of the effect of USPTO electronic information policies on public access to patent and trademark information. This "Study 22" began on March 10, 1988.

[177] International Computaprint Corp. v. U. S. Department of Commerce, Civil Action No. 87-1848 (D.D.C.); Thomson & Thomson v. International Computaprint Corp., Civil Action No. 88-0839 (D.D.C.). On August 16, 1988, the district court granted summary judgment in favor of the USPTO in No. 88-0839, holding that Thomson & Thomson, a contractor to USPTO had no proprietary interest in microfilm of trademarks sufficient to preclude FOIA disclosure of the microfilm to Computaprint. Cross motions for summary judgment in No. 87-1848, involving computerized trademark data were pending as of this writing.

[178] ___ F. Supp. ___, Civ. Action No. 87-1848, memorandum op. (D.D.C. Aug. 16, 1988).

The intervenors argued (1) that the FOIA does not compel access to agency efforts to compile, organize or computerize publicly available information,[182] (2) that the FOIA does not compel creation of computer readable media,[183] and (3) that the computer process for organizing trademark information implicitly sought qualified for protection under FOIA Exemption 4.[184]

When USPTO subsequently decided to release microfilm containing certain of the requested information, Thomson & Thomson brought a "reverse FOIA suit" to prevent release of allegedly proprietary information contains in the microfilm. On August 16, 1988, the district court, by memorandum opinion, granted summary judgment in the reverse FOIA case, finding that the contents of the microfilm were in the public domain because Thomson & Thomson's proprietary information was not used to prepare them, and therefore failed to meet the confidentiality requirement of Exemption 4.[185] It rejected claims based on contracts between USPTO and Thomson & Thomson on the grounds that exclusive jurisdiction over such breach-of-contract claims lies in the United States Claims Court.[186] The court reserved judgment on the other FOIA questions raised in the original lawsuit.

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[179] Complaint at Appendix B (USPTO letter denying FOIA request).

[180] Memorandum in Support of Plaintiff's Motion for Partial Summary Judgment at 10 (Oct. 16, 1987) [hereinafter "Plaintiff's Memorandum"].

[181] filed Oct. 26, 1987.

[182] Defendant-Intervenor's Memorandum of Points and Authorities in Opposition to Plaintiff's Motion for Partial Summary Judgment and in Support of Defendant-Intervenors' Cross-Motion for Summary Judgment [hereinafter "Intervenor Memorandum"] at 4-10.

[183] Intervenor Memorandum at 14-16.

[184] Intervenor Memorandum at 22.

[185] August 16 Slip Op. at 13-14.

Certain technology issues remain unresolved regarding wide public dissemination. Access to image data through workstations resembling those used by examiners would require datalinks capable of speeds in the 800 kilobit to 2 megabit per second range. Optical fiber and satellite links are being considered to meet these requirements, as well as serving the need for international filing and dissemination.

G. Office of the Federal Register

The Office of the Federal Register("OFR"), a part of the National Archives and Records Administration, has responsibility for a broad range of information dissemination. The Federal Register Act,[187] and §552 of the Administrative Procedure Act[188] require that certain agency documents intended to have legal force and effect must be published in the Federal Register. In addition, a wide variety of agency regulatory activities are required to be noticed in the Federal Register.[189] The Federal Register therefore is a kind of central textual database in printed form for agency dissemination of information. Certain types of agency regulatory information, such as comments and regulatory records developed in adjudicatory litigation, are not published in the Federal Register but are disclosed, usually in public reference rooms maintained by the agencies.

Agencies must submit Federal Register notices to the Office of the Federal Register, which verifies that they have been signed by an authorized official, reviews, edits and schedules the documents for publication, makes them available for public inspection on the day before publication and sends them to the Government Printing Office. The Government Printing Office prints the Federal Register daily and distributes it to subscribers, Federal agencies, Congress, the courts, and depository libraries.

In addition, the Office of the Federal Register has the entire responsibility for codifying federal regulations into the Code of Federal Regulations. For this purpose, in cooperation with the GPO, it maintains a textual database into which are inserted the regulatory texts of Federal Register documents as they are published.

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[186] August 16 Slip Op. at 20.

[187] 44 U.S.C. Chapter 15.

[188] 5 U.S.C. §552 (1982).

[189] *See* §V(B)(1)-(2).

At the present time the Federal Register publication process is a paper process at the agency and the OFR level. Agencies submit documents in paper form to the OFR, OFR reviews and edits them, and sends the edited copy in paper form to the GPO. At the GPO, the documents are keyed into a computer system, at which time typesetting codes for GPO's Atex system are added, and the resulting computer files are run through GPO's phototypesetters.

1 *Electronic Acquisition*

The Office of Federal Register and the GPO have embarked on two modest pilot programs to automate the submission process. One pilot program permits agencies to submit paper information according to restricted formatting instructions. The paper information is scanned electronically at GPO, saving keyboarding labor and delay.

The second pilot effort permits agencies to submit Federal Register notices and documents on computer readable tapes and diskettes. Agencies submitting electronically must add typesetting codes before the diskette is sent to the Office of Federal Register. Because of the additional burden of adding these codes, few agencies have participated for very long in the diskette submission pilot program. An exception is the Nuclear Regulatory Commission, which sends a disk every other week with notices regarding certain proceedings. The Office of Federal Register does not even read the disk, but receives a paper duplicate which it uses to meet the signature authentication and public display requirement.

The GPO presently has an Antares conversion system that can translate disk and file formats. The Joint Committee on Printing of the Congress submitted the Congressional Directory in a proprietary Data General wordprocessing format, and GPO converted it to the necessary Atex typesetting file with the Antares system.

In addition to these pilot programs, the Office of Federal Register sends daily corrections to the GPO on diskette. These daily corrections are keyed by OFR personnel on an IBM PC running Xywrite wordprocessing software.

Ideally, an agency could submit documents to OFR in electronic form, using whatever format is provided by the agency's standard wordprocessing software, and the GPO would insert requisite typesetting codes. Alternatively, the insertion of typesetting codes could be done by OFR as a part of the review and clearance process. If OFR undertakes conversion, OFR could check style and format. Either OFR or GPO would need to review diskette submissions at some point, to ensure that the agency submission follows style conventions relating to heading, text and table formats.

2 *Electronic Release*

Electronic dissemination of the Federal Register and the Code of Federal Regulations potentially offers significant benefits, while raising a host of policy and budgetary issues.

The OFR is participating in a GPO-sponsored pilot project to test the feasibility of transmitting government publications over unused portions of the FM radio band. The pilot involves FM transmission of the daily Federal Register for a 90-day period to six Federal government end users for evaluation.

OFR also has provided several Federal agencies with electronic copies of selected portions of the updated Code of Federal Regulations and recently published Federal Register documents. The material was provided on magnetic tape, floppy disk, or telecommunicated, and formatted for typesetting or word processing. Agencies used the material to print specialized publications, for information retrieval, and for document drafting.

Presently, GPO sells a tape of its typesetting files to any requester.

3 *Issues*

GPO/OFR electronic acquisition issues are primarily technological. Agencies have few incentives to submit information electronically because they must bear the cost of adding typesetting codes. The incentives for electronic filing could be increased if agencies were permitted to submit in one of several defined word processing formats, with GPO or OFR bearing the cost of converting the word processing files and offering quicker publication of notices submitted electronically.

The GPO/OFR electronic release possibilities involve the same issues regarding public and private sector roles as other electronic publishing initiatives discussed in this report.

Some requesters of GPO typesetting files for statutory and regulatory material have balked at the high cost, resulting in part from the fact that the GPO spreads Federal Register and CFR material over many tapes. Despite pressure from the Joint Committee on Printing, GPO does not make available the same information on microcomputer diskette or CDROM media. Nor does it provide dialup links. OFR provides copies of the CFR in machine readable form to Federal agencies upon request.

The major opposition to GPO electronic dissemination in a wider variety of formats comes from the major existing publishers of the information, especially Mead Data Central and West Publishing who currently have the only on-line databases that include full text Federal Register.

There is inconsistency in the GPO's current state. Plausible arguments can be marshalled that the government should not retail information.[190] But if these arguments are accepted, the GPO should not be printing, publishing and distributing the Federal Register or the Congressional Record.[191] If it is appropriate, conversely, for the government to engage in this level of dissemination of Federal Register and Congressional record contents, then it may be equally appropriate for the same information to be disseminated in electronic form, depending on relative costs and benefits of electronic versus conventional publishing and distribution.[192] Electronic dissemination would broaden the accessibility of the information and its timeliness, two core policies motivating enactment of the Federal Register Act and section 552 of the Administrative Procedure Act.[193] This is especially true if electronic dissemination occurs through depository libraries.[194]

Little capital expenditure would be required, and little operating cost, for the Government Printing Office to make its raw data available in CDROM and diskette media.[195] All that would be necessary is to buy the necessary disk drives.

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[190] *See* §V(F)(2) for an explanation of the distinction between retailing and wholesaling of government information.

[191] These would be policy arguments, not legal arguments. Publication of both documents are required by law.

[192] *See* Recommendation C.

[193] *See* H.R.Rep. 1497, 89th Cong., 2d Sess., reprinted in 1966 U.S.Code Cong. & Admin. News 2418, 2420.

[194] *See* §III(H) for a discussion of depository library roles. Most of the contemplated depository library activities involve GPO.

[195] *See generally* Pietrucha, *Library of Congress Readies Catalog on CD-*

On the other hand, for GPO itself to get into the on-line database activity would require a major investment in communications hardware and software. Additional storage capability may be necessary, because GPO currently has the information off-line on magnetic tape for its own internal typesetting and printing needs.

If GPO were to undertake providing on-line dissemination of the Federal Register, CFR and Congressional record information, GPO also could become a kind of central electronic dissemination agency for a wide variety of agency information. For example, an agency wishing to provide electronic disclosure of a regulatory docket,[196] could provide the contents of the docket in electronic form to GPO, and GPO would take care of providing public disclosure. Obviously, this kind of clearing house function would increase substantially the processing and storage hardware requirements at GPO.

H. Federal Depository Libraries

References are made throughout this report to "public" availability. In reality, a relatively small portion of the general public has access to microcomputers and therefore the technological capability of using government information in an electronic form. So in the near term, until every citizen has a microcomputer, the concept of "public" disclosure really means (1) direct availability to certain technologically sophisticated constituencies, such as investors, inventors and patent attorneys, tariff filers or medical researchers, or else it means (2) indirect availability to members of the general public using agency public reference rooms or public libraries.

The depository library system is an existing institution meant to facilitate distribution of government information to members of the general public.[197] There are more than 1300 libraries in the United States serving as statutory federal depositories. At least one depository library is located in each of the 435 congressional districts.

ROM, Gov't Computer News, April 1, 1988 at 72 (reporting on plans to make bibliographic information available on CDROM beginning in 1988).

[196] *See* §III(K) discussing Nuclear Regulatory Commission activities. and III(D) regarding FERC electronic dockets.

[197] 44 U.S.C. §§1901-1914 (1982).

Depository libraries receive publications issued by the Executive, Judicial, and Legislative branches at no charge in exchange for providing free public disclosure. The depository library system is administered by the superintendent of documents within the U.S. Government Printing Office.

1 Automation Activities

In 1984, an ad hoc committee prepared a report for the Joint Committee on Printing of the United States Congress, on provision of federal government publications and electronic format to depository libraries.[198]

This report found that some mechanisms already were in place for the distribution of electronic data, such as:

— distribution of data tapes or disks directly by agencies like the Bureau of the Census to specific constituencies

— sale or lease of tapes or magnetic disks by NTIS, the National Library of Medicine and the Department of Agriculture

— sale of electronic photo composition tapes by the GPO as in the case of the Federal Register

— free access by patent depository libraries to the Patent Office classification and search information system

— fee-based database systems,

— fee-based on line access to National Library of Medicine and chemical substances information network databases and fee-based

— on line access to government information via private sector databases, such as dialogue, BRS, ORBIT, LEXIS, and WESTLAW.[199]

The committee found that a large portion of the depository libraries already make use of communication links for accessing databases.[200] The task force recommended a series of pilot projects and listed government publications already available electronically, and desired by respondents.

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[198] S.Prt. 98-260, 98th Cong., 2d Sess.(1984).

[199] S.Prt. 98-260 at 2.

[200] Eighty-six percent of the libraries responding to a task force questionnaire used at least one telecommunication service.

On April 9, 1987, the Joint Committee on Printing adopted a resolution urging the Government Printing Office to initiate a series of pilot projects to test disseminating government publications to depository libraries in electronic format. The plan adopted pursuant to the resolution envisions five pilot projects, three involving distribution via CDROM and two involving online dissemination.[201]

The Census Bureau project involves distributing CDROMs containing data and Census developed retrieval software and hard copy documentation for the 1982 Census of Retail Trade by Zip Code and the 1982 Census of Agriculture. The CDROM disk is the same one used in a direct census bureau project with participating depository libraries.[202] The project will help Census decide whether parts of the 1990 Decennial Census should be published on CDROM.

EPA plans to distribute the Toxic Release Inventory ("TRI"), containing information on 300 toxic chemicals being released to the environment. The data collection activity is mandated by the Superfund Amendments.[203] The Toxic Release Inventory will be distributed on CDROMs along with contractor developed software. The GPO will pay the cost of the software license fees for use of retrieval software.

The GPO will distribute the final bound edition of the Congressional record on CDROM. Plans are uncertain about full text retrieval capability and other technical issues.

The Department of Commerce will provide online disclosure of the Economic Bulletin Board sponsored by the department.[204]

The Department of Energy will offer a "gateway" providing about twenty depository libraries online access to bibliographic abstracts on energy subjects.

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[201] Congress of the United States, Joint Committee on Printing, Dissemination of Information in Electronic Format to Federal Depository Libraries: Proposed Project Descriptions, (June, 1988; Cover Letter from Representative Frank Annunzio and Senator Wyndall H. Ford to "Members of the Information Community," dated July 13, 1988).

[202] *See* §III(W) .

[203] *See* §III(V).

[204] *See* §III(O).

2 *Issues*

The Task Force Report identified a number of policy issues:

1 Should government information be transmitted to libraries through existing bibliographic utilities such as OCLC?

2 Should government data be distributed to depository libraries through private sector database vendors such as Mead Data Central, SDC and West Publishing?

3 Should the government subsidize hardware acquisition by libraries?[205]

4 Should a centralized database be provided for access by libraries, or should regional data centers be organized around subject interest or geographic areas?

5 Should "intelligent gateways" allow depository libraries to access different databases through a common, user friendly interface?[206]

I. DOT International Tariff Filings

The Department of Transportation is responsible for economic regulation of the airline industry. Under the Federal Aviation Act,[207] carriers providing international transportation of passengers or freight must file tariffs for DOT review and approval. In 1988, some 40,000 pages of tariffs, including about 2,000,000 individual rates and rules were on file with DOT. Some 120 carriers file these tariffs, 90% through tariff filing agents. The largest tariff agent is Airline Tariff Publishing Company (ATP), owned by domestic and foreign airlines. Official Airline Guide, a subsidiary of Dunn & Bradstreet, participated as a tariff agent until recently, but has withdrawn from the business. ATP collects tariff information in electronic form, organizes it for reinsertion into airline reservation systems, and prints tariff pages for filing with DOT. ATP will make information available to any requester in magnetic tape form or via an online terminal.

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[205] S.Prt. 98-260 at 8.

[206] S.Prt 98-260 at 9.

[207] 49 U.S.C. §1373(a).

The demand for tariff information is primarily for use in airline reservation systems used by virtually all travel agents and airlines, though the systems have been developed by a handful of airlines. ATP has filed a petition with DOT that it be permitted to file tariffs electronically, accelerating DOT efforts to develop policies for conversion of the tariff system to electronic media.

1 DOT Proposal

An advisory committee developed recommendations on two issues: (1) the present requirement that tariffs be posted in airline sales offices in paper form,[208] and (2) availability of database, communications, and retrieval technologies for use in an eventual electronic tariff system.[209]

DOT and its Transportation Systems Center are working to define a comprehensive electronic tariff system.[210] Actual operation of an integrated system is not expected before about 1991. On December 16, 1987, ATP filed a petition for an emergency rulemaking to permit tariffs to be filed electronically, and on July 8, 1988, DOT published a notice of proposed rulemaking ("NPRM") in response to the petition.[211] The NPRM contemplates electronic filing of passenger fares, including arbitraries, footnotes, routings, fare class explanations and related Special Tariff Permission Applications.[212] The NPRM noted that 17 comments were received on an earlier ANPRM, all but one of which supported electronic filing.

The NPRM proposed that electronic filing not be mandatory but rather an alternative to paper filing. The goal of the proposed rule is to provide interim relief from the burdens of filing and processing paper tariffs, pending implementation of a comprehensive, fully integrated, electronic tariff system along the lines proposed by the Department Transportation Systems Center. The ultimate, fully integrated, electronic tariff system would assemble tariff data in one official central database either inside or outside Departmental headquarters, where software would perform or facilitate the performance of analysis of tariff filings for conformity to statutory and regulatory requirements.

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[208] *See* 53 FED.REG. 27351 (Jul. 20, 1988) (proposed rule allowing carriers to make tariff information available to public in electronic form).

[209] 53 FED.REG. at 25616 (Jul. 8, 1988) (describing advisory committee activities).

[210] 53 FED.REG. at 25616.

[211] 53 FED.REG. 25615 (Jul. 8, 1988).

[212] ("STPAs").

The NPRM proposes that any carrier or its tariff filing agent be allowed to file its passenger fares electronically by establishing and maintaining a database of all such fares. The Department would record its decisions regarding fare filings into the database. The Department of Transportation and the public would have unlimited access to the database at DOT headquarters, at no charge.[213] DOT would install a local area network, connected to personal computers in DOT offices. Filers desiring to file tariffs electronically must install hardware, software, and communications devices needed to interface with the Departmental system. Electronic filing would be accomplished by means of a leased dedicated conditioned data circuit. The Department would download all daily data transmitted into DOT computers. As a means of error checking, the filer must furnish on a daily basis all transactions made to the online database in machine readable form. DOT would compare the machine readable submissions with the daily transaction record to insure that the daily transaction record is complete.

Electronic filers must continue to file on paper for a period of 90 days.[214]

Electronic filers must place one or more computer video display terminals and one or more printers connected with the online tariff base at DOT's tariff's reference room. In addition, electronic filers must afford access to their online databases to any member of the public, at a charge that does not exceed a reasonable estimate of the added cost of providing the service [215]

The NPRM explains why DOT rejected a number of alternatives. Storing images of tariff pages on optical disks was rejected because it would not permit automating DOT's analytical or clerical functions.[216]

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[213] 53 FED.REG. at 25618.

[214] 53 FED.REG. at 25619.

[215] 53 FED.REG. at 25620.

[216] 53 FED.REG. at 25621.

2. *Issues*

None of the information in the tariff base is confidential, so DOT in designing an automated system does not confront Privacy Act and FOIA exemption screening problems.[217] Also, data security questions are narrowed because unauthorized access simply to retrieve information is not a concern.[218] DOT is concerned, however, with security issues relating to data destruction or data alteration. Superficially, it may be that these aspects of security will present fewer risks in an electronic tariff system than in the current paper system. A person could remove or substitute a page of a paper tariff without ready detection.

The main policy issues confronting DOT automatic tariff system planners involve the degree to which DOT should develop a system that performs functions presently performed by private sector actors.

On the acquisition side, this issue presents itself in terms of whether DOT should contract with ATP—or, theoretically, someone else—actually to maintain the tariff database, should maintain the database itself but set filing requirements in a way that they can be met easily by ATP with its existing system, or whether DOT should maintain the database itself and design the acquisition portions so that airlines can file directly with DOT, bypassing ATP. OMB and House Policy Report guidelines would suggest that DOT would rely to the maximum extent on ATP,[219] but ATP's dominant position in the market raises questions about whether such a DOT approach would have the effect of perpetuating a monopoly. The NPRM temporarily would resolve this question by relying on access to private databases by DOT and the public.

On the release side, the issue presents itself in terms of how DOT should allow access to electronic tariff information and to additional origin and destination data maintained by DOT which usefully can be combined with tariff data. ATP prefers that DOT strictly limit release of electronic data to tapes of the database and to online terminals in DOT's Washington headquarters. Obviously such an approach would minimize disruption of markets and would limit DOT to a strictly wholesaling function, adding little value to the raw data. On the other hand, the purpose of an economic regulatory regime that relies on tariffs is to promote the availability of tariff information to consumers of the regulated services. Obviously this regulatory objective would be furthered by more active dissemination of electronic data by DOT or directly by the tariff filer.[220]

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[217] *See* §V(B) and §V(C)(2).

[218] *See* §V(C)(1).

[219] *See* §V(B)(6), (8).

It is notable that the Department avoided data structure and format standardization issues and government-provided online access issues by the approach of providing filing and release via individual, private sector-maintained databases.[221]

The ultimate resolution of DOT's information release role well may be determined by the marginal cost of adding additional value of benefit to ultimate consumers. Perhaps if DOT can provide information in a form more useful to ultimate consumers at very little cost, OMB might be induced to approve adding more value, thereby moving DOT further toward retailing of the information.

The differences between the DOT tariff and the FMC system are significant, despite the superficial appearance of similarity between two transportation tariff systems. DOT's information base primarily involves passenger tariffs; FMC's primarily involves cargo tariffs. The structure of the existing industry for tariff filing and dissemination is completely different between the two agencies. ATP's position in preparing tariffs for filing is much more dominant than any actor in ocean tariffs. The degree of automation presently existing in the airline industry is much higher than in ocean shipping, and the demand for information to be used in highly automated airline reservation systems is sui generis to airline tariffs.

J. Interstate Commerce Commission Tariff Filings

1. *Overview*

The Interstate Commerce Commission has issued a Notice of Proposed Rulemaking ("NPRM") for electronic filing of tariffs.[222] The proposal permits rail and motor carrier tariffs to be filed in non-paper form if (1) the form is compatible with existing ICC technology and facilities for receipt, storage and use, or (2) the filer provides the ICC with equipment, facilities and programs for use by the Commission and the public at no charge.[223] An electronic filer also must make equipment available at its principal office, at no charge, to permit the public to inspect its tariffs.[224]

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[220] As under most tariff systems, airlines must make their tariffs available to the public.

[221] 53 FED.REG. at 25622.

[222] 52 FED.REG. 39549 (Oct. 22, 1987).

Carriers favoring the proposal asked for additional time to respond to the comments of persons raising questions about the proposal,[225] and the proceeding is still pending.

The original initiative for automating ICC tariff automation came from motor carriers, seeking to file mileage tariffs electronically. The project has expanded to include rail mileage and rate tariffs. At the present time, some railroads have mileage tariffs in their mainframe computers available on terminals located at the ICC, maintaining parallel paper information. The ICC favors the electronic acquisition initiative because of the potential for reducing clerical costs.

The ultimate carrier goal is to maintain tariff information in carrier computers and to give access to the ICC and to the public (including shippers) via microcomputers and modem. Anyone with a microcomputer and a modem could obtain dialup access. Resellers of tariff information could obtain bulk data through batch processes from the carrier computers.

2. *Issues*

Under the planned approach, format standardization is less important than standardization of the query interface for the ICC and other users. System proponents expect that the query interface will be largely standard, and that query software will provide extensive help to users. The interface will be "self-educating."

Carriers perceive wide public availability of tariffs is in their economic interest as a marketing tool, so FOIA issues are minimal.

Controversies over public and private sector roles are minimal at the present stage of system implementation. Carriers will pay for and maintain the system, so budgetary issues are less than with the FMC system. Tariff publishing agents, who perform printing, filing, and distributing functions, do not feel threatened because the carriers have promised them a role. Some shipper groups and information resellers, however, have opposed the proposal, arguing that more of an ICC role is desirable.

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[223] *Id.*, Proposed 49 C.F.R. 1314.4(c).

[224] Proposed 49 C.F.R. §1314.11, 52 FED.REG. at 39552.

[225] *See* 53 FED.REG. 5022 (Feb. 19, 1988).

K. Nuclear Regulatory Commission Electronic Docket

1 *Licensing Support System*

The Nuclear Regulatory Commission (NRC) is considering revisions to its Rules of Practice[226] to permit use of a Licensing Support System ("LSS"), an electronic information management system, in the adjudicatory proceeding on licensing receipt and possession of high-level radioactive waste. The proposed revisions were developed in large part through negotiated rulemaking[227] conducted by an advisory committee.[228] The licensing proceeding for the high level permanent nuclear waste repository, scheduled for the early 1990's, is expected to be one of the largest administrative litigation matters ever to come before the NRC. The case is likely to involve 16 million discovery documents and about 20 parties.

NRC administrative law judges are already making extensive use of microcomputer technology to facilitate licensing panel proceedings. Pleadings and other materials are filed by litigants on diskette, transcripts of testimony are provided on diskette, ALJs have full text indexing software and microcomputers, and ready access to electronic mail and computer aided legal research databases.[229]

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[226] 10 C.F.R. Part 2.

[227] *See* Perritt, *Negotiated Rulemaking Before Federal Agencies: Evaluation of Recommendations by the Administrative Conference of the United States*, 74 Geo.L.J. 1625 (1986); Perritt, *Administrative Alternative Dispute Resolution: The Development of Negotiated Rulemaking and Other Processes*, 14 Pepperdine L.Rev. 863 (1987).

[228] 52 Fed.Reg. 29024 (Aug. 5, 1987); 53 Fed.Reg. 3404 (Feb. 5, 1988).

[229] *See* Cotter, *When the Electronic Judge Meets the Electronic Lawyer*, The Judges Journal 4 (Spring 1988).

Due to the volume of documents involved in the average nuclear power reactor licensing proceeding,[230] the Commission believed that traditional licensing procedures would prevent the Commission from meeting the statutory timetable, and would not provide all parties with an opportunity for the most effective review of the license application. The contemplated LSS would contain the information supporting the license application and potentially relevant documents generated by NRC and other parties to the licensing proceeding, in a standardized electronic format. All parties would have access to this system. Because the relevant information would be readily available though access to the LSS, the initial time-consuming discovery process involving the physical production and on-site review of documents by parties will be substantially reduced.

Implementation of this system is intended to accomplish the following objectives:

- Providing comprehensive and early access to potentially relevant licensing information;
- Providing full text search capability of the potentially relevant licensing information; and
- Providing for the electronic submission of formal papers during the licensing proceeding;

When access to the LSS becomes available, currently projected for January, 1991, the NRC, as LSS Administrator, will be responsible for management and operation of the LSS.

The Commission undertook to develop the LSS concept through negotiated rulemaking because it will help to establish the credibility of the LSS, increasing the likelihood that all relevant documents will be entered into the system and reassuring participants that the system would be free from tampering. Support by participants is particularly important because individual parties to this proceeding will possess substantial research data that should be placed into the LSS.

The negotiating committee reviewed a draft NRPM proposing LSS features described in this section in July, 1988. All but one of the interests represented on the committee approved the draft, the dissenting interest expressing concern about the overall cost effectiveness of the concept. The draft has been presented to the Commission for its decision on whether it should be issued as a proposed rule in its present form or not. The proposed rule defines in considerable detail the kinds of documents that must be made available electronically on LSS, including any material or other information generated or in the possession of an LSS participant that is relevant to, or likely to lead to the discovery of information that is relevant to, the licensing of the likely candidate site for a geologic repository. It requires participants in LSS to provide information in ASCII form with certain header information, and also to make available page images. In some cases, page images and headers only need be provided and NRC will translate the documents into free text. Detailed format criteria for submission and acceptance of ASCII, images and headers will be developed by DOE in concert with a a Technical Working Group of the negotiating committee.

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[230] The total database is estimated to involve some forty million document pages.

In concept, documentary material is to be in LSS in searchable full text. A significant portion of the documents, however, will be in the form of graphic material such as maps and technical drawings. Therefore the base conceptual design of the electronic database includes the use of electronic page images. Material that is not searchable full text will be accompanied with headers specifying the location of the information.

Errors in submissions may be corrected in the original submission within certain time limits. Errors discovered after the time limits must be corrected by submitting a separate document with its own header.

The public will have access to LSS only via terminals in public reference rooms. These terminals will provide full text search capability for full headers for LSS documents. Copies of the documents themselves will be available under the FOIA, and from LSS itself after notice of hearing is issued for the licensing proceeding. Remote access for the public from individual computer facilities will not be available. LSS participants will have access from individual computer facilities during the pre-license phase and after the notice of hearing has been issued. LSS participants will bear the cost of their own computer facilities and telephone connect charges, but will not he charged for access to the LSS. Proposed §2.1008 specifies how a person may become a "potential party" during the pre-license application phase, thereby gaining access to the LSS during that period. Discovery during the proceeding presumptively is to be satisfied through LSS. Proposed §2.1013 provides for the electronic submission of pleadings during the hearing, or during the pre-license application phase, for the electronic dissemination of agency issuances and orders, and for on-line access to the LSS during the hearings. Absent good cause, all exhibits tendered during the hearing must be entered into the LSS prior to the exhibit being offered.

2 *Issues*

The LSS is the most ambitious electronic docket system under active consideration by a federal agency. It faces technology challenges because of the need to accommodate page images. It also, like the Customs Service systems,[231] offers a higher level of electronic release for participants in the system in order to create incentives for participation.

L. Department of Energy

The Energy Information Administration (EIA), Department of Energy, has successfully implemented a microcomputer-based data collection for reporting radioactive waste from civilian nuclear reactors. EIA provides respondents with microcomputer software and data diskettes. Respondents verify and update the previous year's data and enter current year data on the data diskettes. EIA analysts review, edit, and verify the received data on microcomputers, and then transfer clean data files to the EIA mainframe computer for storage, aggregation, and distribution. EIA finds that the system reduces reporting errors and greatly speeds the reporting cycle.

M. National Library of Medicine

The National Library of Medicine[232] provides a computerized system called the Medical Literature Analysis and Retrieval System ("MEDLARS") for storing, indexing, and retrieving medical bibliographic data. Direct access to MEDLARS is available by subscription to MEDLINE, an on-line reference retrieval system.[233] In addition, the public can buy tapes containing the complete MEDLARS database. The tapes are priced so as to permit recovery of capital cost of creating

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[231] *See* §III(C).

[232] *See generally* 42 U.S.C. §275, establishing the National Library of Medicine.

[233] *See generally* SDC Development Corp. v. Mathews, 542 F.2d 1116, 1117 (9th Cir. 1976) (describing MEDLARS).

MEDLARS.[234]

A House committee has criticized the National Library of Medicine for restricting access to its MEDLARS database. While the NLM charges user fees for on-line access that may approximate marginal costs of providing the information, much higher charges for copies of the entire database, re-disclosure restrictions imposed on licensees of the entire database, and the agency's successful litigation in *SDC Development Corp. v. Mathews*,[235] support an inference that the agency restricts pre-access to its database in order to support higher than marginal cost-based user fees.[236] The Government Operations Committee believes that lower user fees would permit more people to use the information, enabling the agency to do a better job of carrying out its statutory responsibility to "aid the dissemination of scientific and other information important to the progress of medicine and to the public health."[237]

N. USDA

The U.S. Department of Agriculture disseminates information such as daily market reports, weekly and monthly crop and livestock statistical reports, periodic economic outlook and situation reports, news releases, foreign agricultural trade leads, export sales reports, and weekly world agricultural production and trade round ups through its Electronic Dissemination of Information ("EDI") system.[238] EDI is operated by a contractor selected through competitive procurement, currently Martin Marietta Data Systems. Under its contract with USDA, the contractor must assure equal access by all customers upon release by USDA of market sensitive data. The contractor only sells computer time and use of retrieval software to retrieve USDA data in the contractor's computer system. Thus the contractor sells only wholesale information and is prohibited contractually from establishing its own dissemination system.[239] The Government Operations Committee praised the USDA system.

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[234] 542 F.2d at 1118.

[235] 542 F.2d 1116, 1120 (9th Cir. 1976) (denying FOIA request for electronic database of MEDLARS, in part on grounds that FOIA disclosure would undercut pricing structure).

[236] House Policy Report *supra* note 124, at 32-33.

[237] House Policy Report *supra* note 124, at 34.

[238] House Policy Report *supra* note 124, at 63.

In making the decisions leading to EDI, approximately four years ago, USDA adopted two basic policy principles: (1) USDA should not compete directly with existing agricultural information vendors by offering value-added data directly to end users, and (2) all persons desiring USDA information should get it at the same time. The first principle is reflected in the nature of the system. The second principle is reflected by explicit requirements in the contract with Martin-Marietta. USDA made policy judgments not to confront established information distributors even before considering the costs and benefits of its EDI system.

EDI is aimed at information resellers; not at ultimate consumers of information—though anyone may subscribe. Subscribers make contractual arrangements with the contractor, including billing arrangements, and means of access. The contractor provides dialup or dedicated line links via the major PDNs and via its own public data network. Subscribers typically provide the contractor with criteria for information desired from the system. The system will automatically establish contact with the subscriber's computer and automatically transmit new information meeting the user-provided criteria, or put new information meeting the user-provided criteria into a mailbox from which the subscriber can retrieve it.

EDI contains little formatting and little retrieval software, except for a menu-structure necessary to access individual documents as they are released by USDA agencies. Minimum usage fees are set to make the service more attractive to high-volume subscribers intending to resell the information than to ultimate end users.

The USDA/Martin-Marietta contract does not prohibit USDA from initiating a value-added electronic release system that would compete with the Martin-Marietta system, and it is theoretically possible for an enterprise desiring to resell USDA information to bypass the Martin-Marietta system by obtaining information directly from USDA under the FOIA.[240] But such requests have not materialized, probably because information is available much more quickly through EDI than under the FOIA, and also is available in a standard format. Electronic responses to FOIA requests would not have a standard format and would take significant time to process.

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[239] House Policy Report *supra* note 124, at 63.

[240] *See* §V(F)(4)(a)(vi).

USDA presently is considering the best approach for releasing historical data: probably on optical disks with associated indexes and a structure that would match widely available retrieval software, and is reviewing the EDI policy judgments in preparation for rebidding EDI.

O. Department of Commerce

The Department of Commerce sponsors an electronic bulletin board called "The Economic Bulletin Board" ("EPB"). The EBB contains economic news and several hundred statistical files published by the Bureau of Economic Analysis, Census Bureau, International Trade Administration, National Technical Information Service, Federal Reserve Board, Bureau of Labor Statistics, and the Internal Revenue Service. The Department administers the EBB itself. Presently, there are about 900 subscribers, including about 100 libraries. Commerce normally charges users $25 per year plus $6 per hour (prime time), or $3 per hour (non-prime time). The EPB appears to be kept current, and the communications protocols and registration procedure are straightforward.

In addition, the Department offers a service via the commercial Compuserve permitting applicants for export licenses to file their applications electronically.

P. Food and Drug Administration

1 Electronic Bulletin Board

FDA provides press releases, the weekly recall list, the drug and device product approvals list, the drug bulletin, the FDA Consumer, Veterinary Medicine News, summaries of FDA federal register documents, congressional testimony and speeches delivered by FDA officials, on an electronic bulletin board operated by a commercial vendor.[241]

2 CANDA

CANDA is an acronym for Computer-Assisted New Drug Application. A CANDA is a computerized database which allows an FDA reviewer online access to information on the drug being reviewed.

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[241] House Policy Report *supra* note 124, at 62.

About three years ago, the FDA and the Pharmaceutical Manufacturers Association ("PMA") undertook a joint project to explore the use of automated data systems to facilitate the drug review and approval process. FDA already had fifteen years of limited experience reviewing biopharmaceutical and statistical portions of NDAs with computers. Many reviewers who had used computers to review data found them invaluable. Separately, PMA urged the Office of Management and Budget to include FDA on a list of agencies eligible to study computer-assisted acquisition of information, including NDAs and investigational new drugs. In comments to OMB, PMA said computer use would reduce the need for paper, increase timeliness in processing information and boost management efficiency.[242]

The ultimate goal is an automated process to improve the quality of FDA review and reduce the time required for review. Both FDA and PMA, however, believe that it is too early in the development process to be able to determine the extent to which the goal can be achieved.

The first phase of the joint project involves experimentation. PMA and FDA encouraged companies to develop pilot submissions of portions of NDA data in a variety of computerized formats. The pilot submissions are intended to ensure that future options are not limited by particular technologies or premature standardization. The second phase of the project involves synthesizing pilot project experiences in order to provide general guidance to sponsors interested in submitting CANDAs.

In the first phase, each submitting sponsor may decide what it wants to submit in electronic form. This could range, for example, from the electronic submission of information to be put on labels, to the results of human trials. Such proposals are evaluated by the sponsor and by the FDA to determine what benefits may result from the experiment. FDA recently received the first complete NDA on an optical disk for medical review.

The primary focus so far has been on the clinical and statistical portions of an NDA. In addition to pilot tests involving these data, efforts also are underway to look at ways to computerize data submitted in other sections of an NDA, such as biopharmaceutics, toxicology/pharmacology, and chemistry, manufacturing and controls.

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[242] PMA comments on Aug. 7, 1987 proposed policy guidance on agency electronic data acquisition. *See* §V(B)(6).

So far FDA has received 24 CANDAs for medical review. The agency has approved one of these CANDAs, and others are under review. They have no substantial text, but consist of tables, laboratory results, and case reports. Although they are not complete NDAs, reviewing them has shown FDA what it will face in the future.

CANDAs are already saving FDA and industry unnecessary steps in processing NDAs. FDA is collapsing what is called "dead time" from weeks into minutes. This "dead time" is the time the reviewer spends waiting for a response from industry after making a request for additional data or for a clarification. With CANDAs, FDA reviewers need not constantly call to get additional data—the data in a CANDA is already on line at the reviewer's fingertips.[243] FDA believes the ultimate payoff can be significant. Reviewers of the future may not have to be in a room with many NDA volumes; in the future with computer-assisted NDAs, reviewers will sit in a room with only a PC at their desks, with the ability to call up any page or subject in a 150 volume NDA instantly—they will only need to press a key.[244]

The FDA has established working groups and three taskforces to work on implementing CANDAs fully. One taskforce is working on a standard user interface that will provide menu-driven options regardless of data input. Another taskforce is studying ways to ensure that data will be kept intact, not altered, pirated, or destroyed while being transmitted or stored in databases.

At this point in their development and evaluation CANDAs cannot be submitted alone. They instead are an optional adjunct to the normal hard copy New Drug Application. So far, NDA sponsors and the FDA have experimented with a variety of computerized forms, including floppy diskettes, hard magnetic disks, magnetic tape and optical disks.

Although submission in electronic form may improve the FDA's ability to analyze data, it is too early to tell whether CANDAs will result in quicker review.

According to the Pharmaceutical Manufacturers Association, there have been four different types of CANDA submissions to date:

1 Submission of NDA clinical/statistical data to FDA by a

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[243] Frank Young Speech to the Association of Food and Drug Officials, June 20, 1988.

[244] *Id.*

third-party intermediary who provides computer expertise and access to the data which reside on the intermediary's computer.

2 Design, development, and delivery of a computerized clinical/statistical database to FDA by the sponsor, who provides access to the data, which remain on the sponsor's computer

3 Limited access to sponsor data via a microcomputer located at FDA The sponsor may provide limited access via "electronic mail" or by the submission of defined data sets on floppy disk.

4 Submission of portions of NDA data on tape, diskette, or other media for use by FDA reviewers on FDA's computer hardware

Most of the following features were included in most of the four types of CANDAs:

— Electronic mail

— Indices to paper data and to computer-retrievable data

— Retrieval and analysis of computer data, on a batch and ad-hoc basis

— Full text search

— Storage of reviewer's notes

— Audit trails

— Word processing

— Graphics

— Statistical functions

Training for reviewers was provided with all CANDAs. Inherent in the experimental environment is the need to familiarize reviewers with a particular electronic submission.

3 *Issues*

The CANDA experiments have identified several issues.

The first issue involves lack of uniformity. Neither sponsors nor FDA feel sufficient experience has been gained and neither wishes to thwart innovation at this point in the evolution of the project. Although uniformity is not achievable now, lack of uniformity imposes some costs, such as those dealing with equipment, software, and training.

A second problem has been the resistance of some of the agency's reviewers to use computers in their reviews. Many reviewers are not computer literate and are hesitant to convert from their standard hard copy inspection process. A smooth transition period from paper to electronic should assure acceptance of CANDA by agency reviewers.

A third problem is that of data integrity and security. PMA and FDA are working to identify issues related to CANDA data security and integrity. Such issues will be addressed on a project-by-project basis, as the pilot program proceeds. Future sponsors' willingness to participate in CANDAs depends on safeguarding their data, trade secrets, and other proprietary information.

4 *Future of CANDA*

By the end of 1988, PMA plans to complete an evaluation of the current pilot CANDAs from the perspective of the FDA reviewer and NDA sponsor. It is hoped that a synthesis of experiences will provide some guidance to those interested in submitting a CANDA.

5 *Field Interchange Specification ("FIS")*

FDA and the pharmaceutical industry are working on a system to allow the biopharmaceutics section of an NDA to be submitted in an electronic format. This system, called Field Interchange Specification (FIS), specifies a common file structure for submission of biopharmaceutics data. The file is designed to allow companies the flexibility to maintain their data in whatever format is currently used in-house, yet allow the reviewer direct access to the data without unnecessary constraints as to database structure.

FIS consists of two programs. The first assists in converting the information to the specified file structure, the second assists in extracting the information for use in data analysis. The main advantage of such a system is that FDA need not specify a standard database structure, and it allows maximum flexibility for both the sponsor and FDA.

The FIS file structure has been designed to allow information about each data element to be associated with the data element itself so that the file is self-documenting. In this way, an FDA reviewer may identify specific data elements to be extracted and thus create the database desired for the analysis to be performed.

Q. National Weather Service

The National Weather Service ("NWS") makes weather and flood information available to the public on a near real-time basis via direct dialup links. NWS offers a family of seven services via medium speed telecommunications lines. The services are priced on a cost-recovery basis, with one-time connection charges ranging from $2,500 to $5,000, and annual "maintenance fees" ranging from $2,500 to $26,500.[245]

In addition, a more limited universe of NWS information is available at much lower cost via commercial services such as Compuserve.

R. The National Institute of Standards and Technology

The National Institute of Standards and Technology[246] Institute for Computer Sciences and Technology (ICST) offers a Microcomputer Electronic Information Exchange (MEIE) bulletin board. This system provides information on the acquisition, management, and use of small computers, and also offers information on conferences, Federal publications and activities, user groups, and other bulletin boards. The service is operated 24 hours a day, except when being serviced.

The author has accessed the MEIE bulletin board and found the information posted there nearly two years out of date.

S. Social Security Administration

Since 1984, the Social Security Administration (SSA) has been encouraging employers to report wage data (W-2 forms) electronically. SSA expects to receive over 60 million W-2s electronically in 1986 and 105 million by 1989.

All employers with more than 500 employees must report electronically after January 1, 1987; after January 1, 1988, all employers with more than 250 employees will also be covered.[247] The primary benefits from electronic collection have been a reduction in the duplication of effort entailed in paper transactions, receipt of better service from SSA, and enhanced efficiencies in information handling. SSA has particularly benefited from more timely posting of earnings as well as reductions in manual activities, errors, and backlogs of paper, tape, and diskette handling. SSA expected a paperwork burden reduction of over 1.3 million hours due to this initiative in FY 1986 and an additional 1.9 million hour reduction in FY 1987.[248]

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[245] National Weather Service, "The National Weather Service Family of Services" (unpublished summary Oct. 19, 1987) (listing prices for FY 1988).

[246] Formerly the National Bureau of Standards.

[247] Treas.Reg. §301.6011-2.; Cf. 26 C.F.R. §1.9101-1 (1988) (permission to file on magnetic tape).

T. Department of Education Gateway and Pell Grant Pilot Projects

The Department of Education is testing the feasibility of major electronic collection projects involving student aid programs: the Gateway and Pell Grant Pilot projects. The Gateway project would provide for electronic processing of the Fiscal Operations Report and Application to Participate, a major reporting requirement for campus-based programs. Respondents may transmit online or via diskette. The Pell Grant Pilot project encompasses the electronic transfer of information associated with the Student Aid Report.

U. FDIC Reports of Condition and Income

The Federal deposit Insurance Corporation (FDIC) plans to achieve a reduction of 41,448 hours in the Call Reports (Reports of Condition and Income), prepared quarterly by insured State nonmember commercial banks. Part of the reduction would be achieved by adopting techniques for generating the Call Reports electronically. FDIC estimates that the average bank saves four hours each reporting period by using computers to produce its Call Reports.

V. EPA/OSHA Emergency Response and Community Right to Know Database

The Environmental Protection Agency and Occupational Safety and Health Administration intend to make toxic chemical release inventory publicly available on a computer database pursuant to §313(j) of the Emergency Planning and Community Right-to-Know Act.[249] This activity is the subject of a separate ACUS investigation and will not be addressed in this report.

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[248] *See* 52 FED.REG. 29454 (Aug. 8, 1987) (OMB policy guidance on electronic collection).

[249] *See* 53 FED.REG. 7567 (Mar. 9, 1988) (announcing public meeting to discuss planned approaches) P.L. 99-499 (Superfund Amendments).

W. Census Bureau

The Census Bureau offers data via the Department of Commerce bulletin board[250] and through commercial vendors.

In addition, Census is experimenting with distributing Census data on CDROM. A first test disk was released in December of 1987 and contains 1982 agricultural data, 1980 demographic and housing data, 1983 population estimates and per capita income for local governments, 1982 manufacturing plant cites, and 1983 county business patterns.

More recently a second test disk was released in dBase file format, which is a major change from the ASCII format of the first test disk. The second test disk contains materials from the 1982 retail trade and 1982 agricultural data. The 1982 agricultural data is an overlap of the first test disk so that the two test disk formats could be compared in terms of user satisfaction.

Test disks were distributed to approximately 1,400 federal depository libraries across the country, many of which already have the PCs and CD ROM players necessary for information retrieval.

Data stored on CDROM is accessed through a simple program provided by the Census Bureau. The Census program uses a simple interface. For instance, if a user wants to retrieve information from a specific table, she is prompted first for the state, then the county. Then the desired information from that table will be displayed.

Users interested in performing more elaborate searches can use dBase III and compatible languages. There is also third party software available used mainly for analytical purposes.

The Census Bureau expects to provide the 1987 economic census and 1990 decennial census on CD ROM. However the goal of the test disk program is only to supplement paper dissemination.

X. State Administrative Agency Programs

Many state administrative agencies sponsor electronic release programs. The absence of any clearinghouse for information about such programs makes is impossible to do more than list those the author knows about, through informal reports from members of the bar and the ABA/net staff.

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[250] *See* §III(O).

Florida's Secretary of State offers corporation information via Compuserve. Summaries of California UCC filings are available in the LEXIS LIENS library. California, Illinois, Missouri and Texas corporation filings are available on LEXIS INCORP library. Florida's Department of Motor Vehicles reportedly permits checking drivers' licenses and license tags on line via Compuserve.

A variety of state and county agencies provide electronic dissemination through Information America. The present system provides information for Georgia, Texas, and California. Information is collected from public agencies and private companies, reformatted for the Information America System and then overlaid with the Information America menu driven search software. Subscribers access the database through Telenet, perform their search and order hard copies of information and documents to which they cannot gain complete access on-line. A cooperative agreement with WESTLAW also allows access through WESTLAW in certain states. Texas public record information is collected from a title company. The California database came online in April 1987 and includes U.C.C., lien, and corporate information filed with the Secretary of the State and payment, sales, and use information filed with the Board of Equalization. Articles of incorporation may be ordered through Information America using its electronic link mail service.

Much controversy has arisen regarding dissemination of state government information in electronic form. Litigation has ensued in New York and Washington, and possibly in other states.[251] Generally, the disputes have involved a governmental claim that electronic information was protected by copyright, or otherwise was not disclosable under state freedom-of-information statutes.

Y. Court Systems

Some judicial information acquisition and release activities provide tempting opportunities for automation. Conceptually, these automation opportunities present the same generic issues as federal agency programs.

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[251] *See* Legi-Tech v. Keiper, 766 F.2d 728 (2d Cir. 1985) (remanding federal First Amendment challenge by computerized legislative information vendor over state denial of access to New York state Legislative Retrieval Service); National Conference of State Legislatures, 1 Legis. Lawyer No. 3 (Nov., 1986) (quoting *Indiana Civil Liberties Union v. Indiana Gen. Ass'y*, No. 55.86.0557, Sept. 11, 1986 (Marion Cty. Super. Ct.) (granting access to recorded debates); Hiskes v. State of Washington, No. C87-256TB, Ord. Issued Jul. 22, 1987 (W.D.Wash.) (dismissing for lack of federal jurisdiction suit to compel disclosure of state statutes in electronic form).

1 *State court programs*

A number of state courts around the country are expanding their use of telecommunications.[252] Many, like the federal courts of appeals, concentrate on linking their own computers together to permit electronic exchange of draft opinions or case management information. Some have developed systems that permit practitioners to access dockets and other court information via telecommunications. Also, there is growing support for possible electronic filing systems.[253]

a. Montgomery County, PA.

Montgomery County, Pennsylvania, has completed a comprehensive courthouse computerization program, which includes automated civil case processing.[254] Docket entries are made electronically, and indices and dockets are available electronically to attorneys, title companies and other agencies through remote online access. The system has reduced the time interval between filing of a paper document and entry into court records to 15 minutes, from five days under the pre-computer system. The records are verified within twenty-four hours of entry, by comparing the computer version with the filed paper. As a security measure, the entire docket and index files are written to tape at the end of each week, and the tape is stored in a vault. A tape also is made of all daily transactions to assist in recovery of the system and database if necessary. The data from the civil docketing and indexing system is used by the court administrator's office to schedule arguments, arbitration hearings and trials. The system considers attorney scheduling conflicts and automatically produces notices to counsel of scheduled events.

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[252] *See generally* M. Clifford & L. Jensen, COURT CASE MANAGEMENT INFORMATION SYSTEMS MANUAL (National Center for State Courts 1983).

[253] Appellate Judges Conference, Judicial Administration Division, American Bar Association, APPELLATE COURTS IN THE TECHNOLOGICAL WORLD 26 (1986) (reporting limited state appellate judge support for electronic filing and inquiry systems).

[254] Other features not considered here include automatic jury and trial scheduling.

Persons inquiring electronically by telephone can obtain attorney schedules, attorney inventories of civil cases, civil and criminal court schedules, complete docket entries on individual cases, corporation and individual suit and judgment searches, tax claim searches by parcel number, and deed searches by parcel number, grantor or grantee name, and by book and page number. In February 1984, outside callers accessed the system at the rate of 2500 calls per month. That rate increased to over 86,000 in August, 1987, and continues to grow. Most on-line requests involve the recorder of deeds, tax assessment and civil case docket databases.

The system now has available on line all 250,000 tax parcels in Montgomery County, over 12,000 domestic relations records, 12,000 criminal and probation filings, and 500,000 documents from the Recorder of Deeds, as well as information relating to some 15,000 attorneys who practice in the Delaware Valley. The attorney information includes address, phone number, trial and hearing schedule, and case inventory. Scheduled enhancements include integrating the Tax Claim, Board of Assessment and Recorder of Deeds records into a single comprehensive database. The court has no plans for remote filing of documents.

The court has licensed the system to Weber County, Utah, Genesee County, Michigan, and to Washington County, Pennsylvania. The court has granted GTE Data Services exclusive rights to offer the Montgomery County system to other courts.

b. Houston, TX

Harris County, (Houston) Texas began developing, in house, a Justice Information Management System in 1974. A pilot project with four Houston law firms permits access to information through dedicated lines. Information cannot be input into the system from these remote access terminals, however. If the final evaluation on the project is positive the system might be expanded to include dialup links on a contractual basis. Concerns with dialup links include security, system capacity, and liability for inaccurate information.

c. Detroit, MI

The Third Judicial Circuit Court in Detroit, Michigan, provides dialup links to court schedules and dockets under a pilot program. Attorneys can access the menu driven system with remote microcomputers and search for information by party name, attorney bar number, or case number for civil or criminal cases. The system automatically schedules court appearances and will automatically schedule around vacation schedules submitted by attorneys. There are plans to connect the scheduling system with other courts so that conflicts resulting in continuances and other delays can be minimized. To support the system, users are charged a subscription fee averaging $50 per month, varying according to the size of the subscribing law firm.

Court personnel are working with the State Forms Committee, a committee of attorneys and court administrators, to develop forms for electronic filing purposes. The current consensus within the court is that electronic filing of domestic relations information, such as address and routine financial data in divorce cases, presents the greatest opportunity for increased productivity. A perceived problem in electronic filing of documents is the lack of uniformity in word processing formatting codes. A long range goal is the storage of complete documents on optical disk storage devices.

d. Fairfax County, VA

The Circuit Court of Fairfax County, Virginia provides the Court Public Access Network (CPAN) which allows attorneys and title companies to access public records through remote microcomputers over leased telephone lines. Land records, financial and tax records, and civil court schedules, dockets and judge assignments can be searched online. No criminal court information is accessible through the system. Currently nine law firms and title companies use the system.

Organizations interested in subscribing arrange for a leased telephone line through the court clerk's office. Usage of the system has increased steadily since its conception as a pilot project in July of 1985. As a result of the positive response, the system became permanent in January of 1987.[255]

CPAN operates using IBM's SNA/SDLC communications protocol. Users need an IBM PC (or compatible) with at least 256K and two floppy disk drives with a SDLC communications adapter and a communications adapter cable. PC Network SNA 3270 Emulation software is required to communicate with the CPAN system. For firms already owning IBM PC (or compatible) equipment an additional investment of about $750 is necessary for hardware and software upgrades. The court presents an information package illustrating that monthly costs for a Title Company making approximately 1300 transactions would be approximately $370. The charges include a clerk's fee of $0.05 per transaction with a minimum clerk's fee of $75 and communications costs of $113.

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[255] Mark Zaffarano, Pockets of Innovation in Local Courts, (unpublished manuscript).

e. ABA/net Court Services

ABA/net provides dialup links to slip opinions of the Seventh Circuit United States Court of Appeals. Opinions are posted on ABA/net for approximately one month to allow publishers and attorneys access to the most recent court decisions. ABA/net has plans for electronic filing of documents. The court will provide a form document and allow attorneys to fill in the necessary fields of information. ABA/net also has plans for providing online access to the Ninth Circuit United States Court of Appeals docket and court calendar. The Michigan Appellate courts have expressed interest in creating a system for the automatic electronic-mail notification of attorneys of court scheduling.

f. Information America Systems

Information America is a private contractor providing subscribers with dialup links to state and local tribunal information.[256] The Fulton County, Georgia, courts provide daily tape updates to the Information America system. The tape records are compiled on an IBM mainframe which is fed by numerous in-house micro-computers. The Fulton County records accessible through Information America include deed records, court calendars, court dockets, trial parties, and attorneys. The Information America software permits auto-searches that will flag the searcher when changes to trial schedules or dockets occur. The Fulton County courts experimented with limited electronic filing capability through the Information America system. On screen forms were provided and the filer could fill in fields. The electronic filing project met with lackluster response and is no longer used.

2 *Federal court programs*

Several electronic information systems of the federal courts are pertinent to the subject of this report because they confront essentially the same technology and policy issues as federal agency programs.

The two major operational systems of interest are the Integrated Case Management System ("ICMS") and electronic mail. ICMS uses structured data. Electronic mail involves free text data. ICMS provides direct public access, and electronic mail has the potential for doing so. The Administrative Office of U.S. Courts ("AOUSC" or "Administrative Office") and Federal Judicial Center also are expanding the number of judicial chambers with microcomputers and LANs, and are planning a nationwide telecommunications network. System implementation is the responsibility of the Administrative Office. The Federal Judicial Center is responsible for system development.

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[256] *See* §III(X) regarding Information America state administrative agency activities.

In thinking about court information systems, it is appropriate to observe a distinction between highly structured data, such as that involving parties, schedules and dockets, and free text data, such as that involved in motions, briefs and judicial opinions. The demand is much greater to automate structured data than to automate free text data. A broader class of consumers desire access to structured data. For example creditors and potential creditors want to know if a particular creditor or potential debtor has filed for bankruptcy. Creditors of a bankrupt may want to know the schedule for the bankruptcy proceeding and to obtain information from the bankruptcy case docket. In contrast, a forty page memorandum of law filed in support a summary judgment motion is likely to be read only by other parties and by the assigned judge.

Most structured information is shorter than free-text information and is intrinsically easier to retrieve based on the contents of particular data elements.[257] All of these factors combine to encourage the courts to automate public access to structured data, and to discourage them from hurrying automation of free text information. The only important exception is direct electronic access to the full text of appellate opinions, a form of electronic information release possible through the word processing and publishing components of appellate court automation systems. Otherwise, the center of gravity of electronic release activities by the federal courts is the ICMS.

a. Supreme Court: electronic release of opinions

The Supreme Court has solicited proposals for a pilot program for electronic distribution of slip opinions.[258]

In August, 1988, the Supreme Court of the United States solicited proposals for making its opinions available electronically in machine-readable form. The Court suggested as a possible approach transmitting all of its slip opinions to a single outside organization which would further disseminate the opinions electronically to anyone who wished access. The Court tentatively contemplated a one to three year experiment with the period of review based in part on the contractor's investment. It expressed an intent to evaluate proposals based on:

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[257] *See* §II(B)(3).

[258] *Modernizing the Court*, NEW YORK TIMES, Aug. 24, 1988, at A16, col. 5.

1. Whether the opinions would be equally available to all interested parties.
2. Whether the proposal favors or appears to favor one distributor or group of distributors.
3. Whether the project would be conducted by a not for profit organization or on a not for profit basis.
4. Whether the project would be conducted by consortium or a joint project by a number of interested parties.

The files to be transmitted from the Court consist of straight text files with embedded ATEX composition codes. The Court contemplated that the contractor would transfer announced opinions from the active court opinion database within the ATEX system to a segregated database on a separate microcomputer located on Court premises. After the opinions are in the microcomputer, the contractor would strip out typesetting codes and/or add its own formatting codes to accomplish electronic dissemination to ultimate consumers. The opinions would be transmitted from the microcomputer to the contractor via a standard modem and telephone links.

The contractor would be required to provide a means of electronic dissemination that would satisfy "varying needs and technologies." The Court's initial solicitation did not specify whether dissemination to consumers must be via telecommunications link or magnetic or optical medium.

The Court anticipated expending only a minimal amount of government funds, if any, on the project.

An informational meeting occurred on Thursday, September 29, 1988, and preliminary proposals were due by COB, November 14, 1988.

b. Lower federal courts: electronic mail

The federal courts use several sophisticated electronic mail systems. These systems permit transfer of documents among judges and support personnel but most do not permit external access. The Third, Fourth, Ninth, and Tenth Circuits presently use electronic mail, and the Fifth and Eighth Circuits have point-to-point telecommunications capabilities. Few district courts have electronic mail yet.

The Administrative Office of U. S. Courts is engaged in a number of activities to improve telecommunications in the Federal Courts. A major goal is decentralization of federal court automation systems. Overall data communications within the federal judiciary are undergoing substantial changes as a result of the decentralization of the court automation system. During the transition, communications with centralized computers in Washington continues to be through dialup telephone lines or via public data networks.

The Administrative Office has ensured that all of the circuit judges in a particular circuit have the same type of equipment and the same word processing software to facilitate this process. The Ninth and Tenth Circuits are using systems installed in 1983 that provide word processing and electronic mail capabilities under UNIX running on CCI hardware. The Eleventh Circuit has an electronic mail system using a dedicated VAX. Presently, none of the courts permits papers to be filed electronically, and few are transmitting opinions to legal publishers electronically.[259] A May, 1985 survey conducted by the ABA Appellate Judges Conference, however, showed that respondents from the federal courts of appeals for the Second, Third, Seventh and Ninth Circuits favored eventual electronic filing.[260]

The United States Court of Appeals for the Third Circuit was the first federal appeals court to use electronic mail, beginning in about 1978. Now, the court routinely uses electronic mail to circulate draft opinions among panel members for revisions and approval. The electronic mail system relies on dialup links to a file server computer. When an opinion is ready for filing, it is transmitted electronically from the chambers of the author to the Clerk's office and from there to the printer of slip opinions. Each circuit judge's chambers and the Clerk's office are equipped with workstations running Word Perfect word processing software. Communications occurs via modem and telephone connection with a VAX 11/750 computer located in Philadelphia. The judges and Clerk's Office personnel have "mailboxes" in the system, so that documents can be sent electronically and received at the convenience of the addressee.[261] It is common practice for judicial support personnel to check their "mailboxes" twice each day and to retrieve documents sent since the last check. Transfer of information on opinion release to the docket is manual, and none of the chambers has electronic access to docket information. The Ninth and Tenth Circuits now are using essentially the same electronic mail system as the Third Circuit.

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[259] The Third, Fifth and Ninth federal judicial circuits and a handful of state appellate courts transmit opinions electronically to printers or publishers. Appellate Judges Conference, Judicial Administration Division, American Bar Association, Appellate Courts in the Technological World 34, 40 (1986)

[260] Appellate Judges Conference, Judicial Administration Division, American Bar Association, Appellate Courts in the Technological World 44 (1986).

Speaking to the Eighth Circuit Judicial Conference on July 24, 1984, Circuit Judge Joseph F. Weis, Jr., characterized the Third Circuit's electronic mail system as an "unqualified success, resulting in the saving of weeks of time in preparation and filing of opinions, as well as the dissemination of the slip opinions." In the same presentation, he outlined enhancements planned for the Third Circuit. The Court is receptive to electronic distribution of slip opinions to the public, by permitting access to them via microcomputer and commercial telephone, but no one has taken the initiative for such a capability. Some thought also has been given to permitting counsel to file motions and documents electronically. Judge Weis has discussed the need for such a capability in general, with examples from other courts, highlighting an Eleventh Circuit system for electronic transmission of last-minute petitions for stays in execution cases.

A private contractor was employed in 1986 to study the data transmission needs within the federal judiciary. The recommendations of the contractor called for:

— A network to serve all data and office communications activities between the courts, and between the courts and the administrative office connecting fourteen major locations including each circuit headquarters (except for shared equipment between Los Angeles and San Francisco) and the Administrative Office.

— Networks serving all data and office automation communications between divisional offices and court headquarters.

— Networks within each court building to serve the intrasite communication needs.

— The network should have permanent technical support on the local, regional and national levels. On the local level, the support personnel are already performing systems support.

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[261] The electronic mail software was written by court personnel.

— The technical architecture and system installation should be performed by an outside contractor (systems integrator) skilled in design, installation, and management of communication networks.[262]

The Administrative Office plans to complete the planning and bidding process and to award the systems integration project contract in fiscal year 1989[263]. Within six months of the contract award the systems integrator will be required to install a pilot system including at least two judicial circuits and the Administrative Office.[264]

c. Lower federal courts: Integrated Case Management System

The Federal Judicial Center has defined parts of ICMS for the appellate[265], district[266] and bankruptcy[267] courts.

The district courts have three to four hundred terminals linked to DEC-10 minicomputers by TYMNET. The minicomputers are located in Washington in Administrative Office facilities. Through this system, District Court clerks have access to an electronic docket sheet for criminal cases[268] and other utilities for keeping track of federal fines.[269] This system is being phased out in favor of locally sited UNISYS minicomputers as CIVIL is introduced.

The federal court system employs several different technologies to permit public access to ICMS. The emphasis in implementing these technologies has been on the busiest district and bankruptcy courts, where the demand for information about cases is greatest. All clerks' offices where ICMS has been implemented have public access terminals. Any member of the public can walk up to one of these terminals, enter a query such as the last name of a possible litigant, and receive information from ICMS about the case. If the user wishes, the terminal will print information in hard copy form. Users often use this means of access to obtain complete docket sheets.

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[262] Five Year Plan at III-3 - III-4.

[263] Five Year Plan at III-5.

[264] Five Year Plan at III-6.

[265] New Appellate Information Management System (New AIMS).

[266] "CIVIL".

[267] Bankruptcy Court Automation System (BANCAP).

[268] Only 15 district courts presently have electronic access to criminal docket information.

[269] Federal fines are tracked through the CVB system on UNISYS computers in selected courts.

The second technology is voice synthesis. A person desiring case information dials a local number, receives 30 to 40 seconds of voice synthesized oral instructions and then uses buttons on a touch tone phone to enter brief queries, such as a docket number or the last name of a potential litigant. The system responds with voice synthesized messages representing elements extracted from the ICMS record for that case, including status information, name of counsel, name of the assigned judge, and scheduled hearings or creditor meetings. A typical voice synthesizer session lasts about 90 seconds.

The third technology is touch screen terminals intended for installation in clerks' offices, or possibly in public reception areas of courthouses. The touch screens serve essentially the same functions as existing public access terminals, though with access to fewer than all of the ICMS data elements.

The fourth technology is dialup links via user microcomputer. The federal court system is strongly committed to an equal access principle and therefore is developing technical characteristics of a dialup links function so as to facilitate availability to anyone with a microcomputer and a 1200 or 2400 baud modem.

A fifth technology, not yet implemented, is a kind of bulletin board service on which would be posted court schedules and slip opinions between the time of their release and their availability in printed form.

The sixth technology involves access to bulk information through a batch process. This technology is of greater interest to resellers of information than to law firms or individuals. The Judicial Center staff presently believes that the best means for providing bulk/batch access is through magnetic tapes.

All of these technologies[270] involve access to ICMS rather than to the universe of free text information possessed by a single court. Based on the considerations described at the beginning of this section, it appears that the large quantity of information, combined with the relatively low demand, makes it uneconomic to keep free-text information in electronic form[271] and, therefore uneconomic to provide for electronic filing for it or electronic release of it. This does not mean, of course, that particular documents might not be acquired and released in electronic form because of the need for speed in filing or service.

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[270] Except for electronic bulletin board technology for slip opinions.

An important development in connection with electronic filing with courts is the capability of BANCAP to accept lists of creditors on magnetic diskettes.

d. Issues

Electronic acquisition and release of federal court information present issues that derive from the decentralized nature of the judicial system. Most information in civil and criminal cases is generated locally, used by local courts, and is of interest predominantly to local consumers. Most information is generated by the parties to a case and is of interest only to the parties and to the judge involved in the case. There are exceptions, of course, involving the handful of cases that attract wide public attention. There also are exceptions for appellate opinions, which are of national interest because of their precedential effect.

Most federal agency information, in contrast is collected centrally, used centrally, and is of interest to essentially national consumers.

But the significant comparative observation about agency and court information systems is that the clear policy direction of federal court information systems is toward decentralization of hardware and of access. The decentralization of access points makes the retailing of information by the courts to the general public less threatening to the markets of private sector information vendors, who can offer a unique "single-stop shopping" service to national consumers even when a particular district or bankruptcy court offers convenient value-added public access to its own information.

Paper court records historically have been available to the public unless they were "sealed" by court order. The foregoing description of federal court automation activities indicates a clear intention to provide electronic release of records having essentially the same content to the extent they are kept in electronic form. The only major legal and policy issue for the courts is whether they should make available bulk data from automated systems.[272] The broad policy question is: if information is available to the public in individual record form in the clerks' offices, should it also be available in bulk form?[273]

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[271] Slip opinions are an exception because of the wider public interest, and the fact that they already exist in electronic form to serve internal word processing and electronic mail goals.

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[272] C. Wirtz, The Impact of Technology on Public Access to Government Records: A Comparison of Federal Agency and Court Policies and Practices 5 (1988) (report prepared for the Administrative Office of U. S. Courts) [hereinafter "Wirtz Report"] (issue first surfaced in the context of the bankruptcy automation programs; recommending uniform federal court automation policy).

[273] Wirtz Report at 7.

IV. COMPARATIVE ANALYSIS OF AGENCY INITIATIVES

This section synthesizes and compares characteristics of the agency programs reviewed in Part III. Syntheses of the legal and policy, and technology issues are presented in Parts V and VI, respectively. The following chart summarizes major characteristics of the major agency electronic acquisition and release initiatives reviewed in Part III.

Agency	Acquisition			Release			
	MAND	INTER	PAGE	ACCESS	DISCL	DISSEM	PRIVATE
SEC	√			√			√
IRS		√					
USCS		√			√		√
FERC	√					√	
FMC	√					√	
USPTO			√	√			
Off. Federal Register/GPO				√			
Depository Libraries					√		
DOT		√			√		
ICC					√	√	
NRC √		√		√			
Department of Energy							
NLM					√		
SDA					√	√	
Department of Commerce						√	
FDA	√						
National Weather Service						√	√
National Inst. of Stds & Tech.						√	
EPA/OSHA Emergency Response						√	
Census Bureau						√	
Supreme Court					?	?	√
Lower Federal Courts							√

In the chart, a check in the column headed "MAND" indicates that electronic filing is mandatory. A check in the column headed "INTER" means that the acquisition program relies heavily on intermediaries. A check in the column headed "PAGE" means that page image data is accepted. A check in the column headed "ACCESS" means that electronic release is limited to access. A check in the column headed "DISCL" means that electronic disclosure is used. A check in the column headed "DISSEM" means that electronic dissemination is used. A check in the column headed "PRIVATE" means that the electronic release activities are designed to rely heavily on private sector resellers.

As the introduction to Part V notes, policy judgments about electronic acquisition and release systems, like other policy judgments, have a political dimension. Agencies have had different degrees of success managing political controversy associated with their electronic acquisition and release plans.

The Nuclear Regulatory Commission has used negotiated rulemaking as a mechanism to reduce controversy. USDA made policy judgments not to threaten established information distributors even before considering the costs and benefits of its EDI system. FMC announced at the outset of its AFTI system that it intended to honor the spirit of the House Policy Report. These agencies undoubtedly learned from the experiences of the SEC and USPTO, which aroused Congressional ire by planning to protect electronic release markets to generate subsidies for internal automation.

A. Electronic Acquisition

Large-scale electronic acquisition programs are being implemented or planned by the SEC, IRS, USCS, FMC, ICC, DOT, and FDA. The SEC, IRS, and USCS systems, though not fully implemented, are using electronic acquisition operationally in support of agency missions. The IRS and USCS systems rely primarily on intermediaries, while the SEC system relies on direct submission by filers. Only the SEC system involves mandatory filing.

The paradigmatic electronic acquisition systems are SEC's EDGAR, permitting corporations to send electronic securities filings to the SEC, and the IRS Electronic Filing Program, permitting third-party tax preparers to file tax returns with the IRS electronically.

Electronic acquisition also is involved in the FERC, FDA and NRC systems, but these programs involve electronic acquisition only for specific regulatory proceedings, rather than for the full scope of the agency's information acquisition efforts. Section C discusses the implications of these systems.

All of the systems, with the possible exception of the FDA system, contemplate primary reliance on direct filing via telecommunications links rather than via physical submission of tape or magnetic or optical disk.

Electronic acquisition of information is relatively non-controversial. In many cases, the initiative for electronic acquisition has come from filers. The ICC and DOT proposals are clear examples. The IRS program makes effective use of a major private sector industry historically involved in filing returns with the IRS.

A variety of approaches to format specification have been followed. IRS and Customs Service paper filings are highly structured. This has made it easier to address compatibility and filing format questions and also has made it easier to design sophisticated databases. The Customs Service has embraced the EDI standard to some extent.

SEC and USPTO data historically were flexible in form. So these agencies face more challenging format standardization issues.

Tariff information, though structured in content, historically was filed and maintained on a page-, rather than an tariff-item basis, with a significant amount of textual explanation and limitations appended to the numerical rate information. Existing private-sector information products containing FMC tariff information are oriented to the tariff page format presently used by the FMC for paper tariffs, and not to a structured database for individual tariffs. The structured database proposed by the FMC permits more flexibility in tariff updating, retrieval, and analysis.

The differences between the DOT tariff and the FMC system are significant, despite the superficial appearance of similarity between two transportation tariff systems. DOT's information base primarily involves passenger tariffs; FMC's primarily involves cargo tariffs. The structure of the existing industry for tariff filing and dissemination is completely different between the two agencies. ATP is more dominant in preparing tariffs for filing than any actor in ocean tariffs. The degree of automation presently existing in the airline industry is much higher than in ocean shipping, and the demand for information to be used in highly automated airline reservation systems is sui generis to airline tariffs. DOT and the ICC adroitly avoided format standardization issues by letting filers use their own systems and formats, maintaining parallel databases and equipping the agencies with access terminals. Such a parallel approach is hard to implement with non-tariff systems, although FDA is experimenting with it as part of its CANDA effort.

To develop acquisition formats limited to machine processable data elements is a much greater departure from existing practice for the SEC, USPTO, FMC and DOT than is involved in automating tax returns or customs entry information. This has made it tougher for those agencies to reach an accord with affected groups on an appropriate database structure and filing format. The change from present practice is less, however, for tariff information than is involved in forcing corporate filings or patent or trademark applications into a completely structured format.

Most of the electronic acquisition systems face a transitional problem: only part of the data is acquired electronically. The remainder must be keyed by government personnel or contractors. The interim arrangement between the Customs Service and the Census Bureau for keying personnel is a good model for other agencies to consider.

Most of the electronic acquisition systems take appropriate account of private sector capabilities. As the chart shows, many rely on filing intermediaries to ease the burden on filers.

The three tariff systems reviewed in the report, the FMC AFTI, the DOT, and ICC systems all raise similar public/private sector issues. Tariff filing and release is highly automated, with the automation services performed by third party enterprises. Indeed the initiative for electronic acquisition of ICC and DOT tariff information came from private sector filers or intermediaries. Private companies already offered both collection and dissemination services respecting FMC's ocean tariffs. So the FMC and DOT were confronted with less need to develop electronic data systems from scratch, but they also has less to offer by way of a new product with significant market value.[274]

IRS and USCS have built their systems around the concept that existing electronic intermediaries will serve as acquisition conduits.

B. Electronic Release

All of the systems discussed in detail, except for the IRS and FDA systems, have major electronic release functions. But the levels of release contemplated vary considerably.

The paradigmatic electronic dissemination program is the Department of Commerce electronic bulletin board, which permits anyone with a desktop computer and modem to dial a telephone number and receive economic statistical information by selecting choices from a menu.

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[274] House Policy Report, *supra* note 124, at 47.

The paradigmatic electronic disclosure program is SEC's EDGAR, which permits retrieval of EDGAR filings from terminals in SEC public reference rooms.

The paradigmatic electronic access program is GPO release of typesetting files for the Federal Register on magnetic tape.

The USPTO *Computaprint* case presents the FOIA issues addressed in Recommendation A. Similar controversies may arise regarding the Customs Service ACS. The main ACS issue is how restricted release of electronic information can be used to induce participation in an electronic acquisition program without running afoul of FOIA obligations. A similar issue is possible if the NRC LSS system provides favored means of availability to parties to the LSS proceeding.

The FERC, Commerce, FDA, NWS and NBS bulletin board programs involve electronic publishing directly by the agencies, with considerable value added. In all five cases, the private sector competes, in some sense, with the agency-sponsored programs through systems that add value in the form of "one-stop shopping." The SEC system contemplates large scale electronic publishing by the private sector and contemplates limiting the agency's role to wholesaling of electronic information and general public disclosure through public reference rooms. The approach is the result of a major controversy over monopoly power, eventually resolved by the Congress. The federal court system presently embraces a similar approach. The DOT and ICC-proposed systems are notable because they contemplate a relatively high level of electronic publishing (or at least disclosure) by the private sector with little agency involvement. The parties from whom information is acquired electronically are responsible for releasing it. Because historically there has not been a large market for information collected by the Customs Service, virtually no one is in the business of collecting and disseminating it. Little controversy has surrounded public/private sector boundary line drawing as to the Customs Service system. Tariff information is much more volatile than financial information filed with the SEC or patent data. Therefore, the likelihood is low that periodic distribution of tariff data via electronic media would be satisfactory. On line access is almost certainly needed.

As with other systems, existing electronic tariff information vendors challenge the need for a new government initiative relating to release. Private companies already offered both collection and dissemination services respecting FMC's ocean tariffs and DOT's airline tariffs.

In the near term, FMC's ATFI represents the most likely battleground for resolution of policy issues with broad implications for the respective roles of public and private sectors in electronic information dissemination. The FMC system presently focuses the policy choice between the wholesaling of bulk information and agency retailing of value-added information. There is room for argument whether the dialup links contemplated by the FMC represent value-added "dissemination" because of the dialup capability, or whether they represent cost/effective "access" or "disclosure" without added value beyond byproducts of the internal automation. The FMC controversy is greater because the FMC contemplates an agency database, unlike the DOT and ICC tariff proposals, which rely on private databases, made accessible to the public. The USCS system is notable because it centers on restricting complete on-line disclosure to participants in the acquisition component of the program.

USDA skillfully managed the public/private sector controversy at the launching of its EDI program, distributing agency information via a private vendor, and ensuring that format and pricing of the data encouraged adding value by other resellers.

Electronic release of court information is influenced by decentralized nature of the judicial system. Most information in civil and criminal cases is generated locally, used by local courts, and is of interest predominantly to local consumers, mainly to the parties and the judge involved in a particular case. Most federal agency information, in contrast is collected centrally, used centrally, and is of interest to essentially national consumers.

Decentralization the retailing of electronic information by the courts to the general public is less threatening to private sector vendors of state-wide or nationwide court information.

State agencies mostly are relying on commercial vendors to market their information electronically, so the public/private sector controversies surrounding many of the federal agency programs are muted at the state level.

Pricing of electronic release products varies. The prices for direct NWS access are obviously much higher than the prices for direct access to the Department of Commerce Economic Bulletin Board.[275] The differences in price may be attributable to (1) much higher capital or operating costs for the NWS system, (2) or recovery of a greater proportion of total cost by the NWS than by the Department of Commerce. USDA charges relatively high fixed prices, and relatively low variable prices, favoring wholesale distribution of EDI information, and presenting advantages to value-added information resellers, while minimizing end-user retail competition with them.

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[275] *See* §III(O).

Generally, when private sector interests oppose electronic publishing initiatives, there is a tendency for political role reversal to occur, present vendors siding with Congress in favor of low or no user fees, and the potential information consumers siding with OMB in favor of user fees.

C. Electronic Dockets

The FERC system is the most mature electronic acquisition and release system oriented primarily toward APA regulatory dockets. It apparently has engendered little controversy. CIPS is a good example of an effective way to publish regulatory information electronically. The author has accessed CIPS and finds it easy to use and up to date.

The LSS is the most ambitious electronic docket system under active consideration by a federal agency. It faces technology challenges because of the need to accommodate page images. It also, like the Customs Service systems,[276] offers a higher level of electronic release for participants in the system in order to create incentives for participation.

The FDA bulletin board is a good example of electronic publishing of regulatory information through a private vendor. The CANDA program is in its infancy, but promises also to become a major electronic docket initiative.

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[276] *See* §III(C).

V. POLICY AND LEGAL ISSUES

A. Introduction

Automation of agency acquisition and release of information raises different policy and legal questions depending on whether one considers the acquisition or the release side of the information flow.[277]

Release is more controversial because agencies have legal duties to release information upon request, and these duties may extend to electronic information. Moreover, agency electronic release has greater potential to compete with established private sector electronic information vendors. And, the consumers of government information are more diverse than the providers of information to the government.

The legal questions are more varied and complex with respect to release than acquisition. The sections that follow discuss, first, the overall legal framework, second, some security and cost/benefit issues common to acquisition and release systems, and then more specific policy and legal issues that pertain to acquisition and release of information.

Policy judgments about electronic acquisition and release systems, like other policy judgments, have a political dimension. Despite the focus of the this part on technology, cost/benefit, and legal factors, decisionmakers must not forget the aphorism that politics is the art of the possible and the science of timing. There is no point in making exactly the "correct" choice according to objective factors but be denied funding or have the Congress amend authorizing legislation to dictate the terms of an electronic system. Agency decisionmakers should define affected parties and consider how their interests can be satisfied.[278]

B. Statutory Framework

Five statutes and three policy statements interact to frame the policy contours of electronic acquisition and release systems: the Federal Register Act,[279] the Freedom of Information Act,[280] the Privacy Act,[281] the User Fee Act,[282] the Paperwork Reduction Act,[283] OMB Circular A-130,[284] draft Commerce Department Guidelines,[285] and the Policy Report of the House Committee on Government Operations.[286] Policy guidance also is provided by information and procurement regulations[287] and by various other OMB circulars.[288] Other statutes covering government contracting and procurement also are relevant.[289]

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[277] *See generally The $3 Billion Question: Whose Info Is It, Anyway?*, BUS. WEEK, July 4, 1988, at 106-107.

[278] *See* Perritt, *Negotiated Rulemaking Before Federal Agencies: Evaluation of Recommendations by the Administrative Conference of the United States*, 74 GEO. L.J. 1625 (1986).

1 *Freedom of Information Act*

The Freedom of Information Act[290] establishes a policy in favor of releasing government information to the general public. Although it does not specifically address information in electronic form, the Act presumptively favors designing electronic release systems so that the public will have access to information stored in electronic form. It does not, however, resolve the question of who bears the cost of formulating queries appropriate to retrieve information according to an FOIA request, nor is it clear on whether software, as opposed to raw data, must be made available.[291]

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[279] 44 U.S.C. §1505.

[280] 5 U.S.C. §552.

[281] 5 U.S.C. §552a.

[282] 31 U.S.C. §9701.

[283] 44 U.S.C. §§3501-3520.

[284] 50 FED.REG. 52730 (Dec. 24, 1985).

[285] *See* §V(B)(7).

[286] *See supra*, note 124.

[287] 41 C.F.R. parts 201-1 to 201-49 (information resources management) and 48 C.F.R. Parts 1 to 53 (federal acquisition regulations).

[288] A-109 ("Major Systems Acquisitions", rev. Apr. 5, 1976), A-76 ("Performance of Commercial Activities") and A-11 ("Preparation and Submission of Budget Estimates, rev. 1987 and annually thereafter). *See also* Ex. Ord. 12615 (Nov. 19, 1987), 52 FED.REG. 44853, 31 U.S.C.A. §501 note (West Supp. 1988).

[289] *See* Competition in Contracting Act, 10 U.S.C. §§2301-2306, 2310, 2311, 2313, 2356 (defense contracting); 31 U.S.C.A. §§3551-3556; 40 U.S.C. §759 (automatic data processing procurement policy and goals); 41 U.S.C. §§251 (note), 252, 253, 253a, 253b, 254, 257, 258, 259, 260, 401-420 (West Supp. 1988) (general procurement); Property Act, 40 U.S.C. §§295, 481, 484, 486(c), 487, 602(c), 757 (procurement policy and coordination); 44 U.S.C. §§2901-2910, 3101-3107 (records management).

[290] 5 U.S.C. §552 (1982).

The Freedom of Information Act obligates federal agencies to release information falling into three categories. First, agencies must publish in the Federal Register substantive rules and statements of general policy and information on agency organization and procedures.[292] Second, agencies must make available for inspection and copying final adjudicatory opinions, statements of policy not published in the Federal Register, and administrative staff manuals and instructions affecting the public.[293] Third, agencies must make available other records not falling within the first two categories upon request.[294] The Act contains nine exemptions, protecting from access, disclosure or dissemination records pertaining to (1) national security, (2) agency personnel matters, (3) matters specifically exempted from access by another statute, (4) commercial secrets, (5) agency deliberations, (6) private personal matters, (7) law enforcement investigations, (8) financial institution examinations, and (9) geological surveys.[295]

The Freedom of Information Act also contains provisions addressing potential conflict between privacy interests recognized in the Privacy Act and pro-disclosure policies. The FOIA resolves the conflict between public access to agency records and individual privacy or proprietary interests by permitting an agency to delete private or proprietary material from records made available. The term used for this selective deletion is "redaction."[296]

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[291] Section V(F)(4)(a) discusses FOIA requirements for electronic release in considerably more detail.

[292] 5 U.S.C. §552(a)(1). 5 U.S.C. §553 also requires proposed rules to be published in the Federal Register to provide an opportunity for public comment. This implicates electronic docket issues discussed in §IV(C) and Recommendation H.

[293] 5 U.S.C. §552(a)(2).

[294] 5 U.S.C. §552(a)(3).

[295] 5 U.S.C. §552(b).

The broadest area of conflict between privacy and access involves application of Exemption 6[297] to the universe of information covered by Subsection (a)(3).[298] The broadest area of conflict between proprietary commercial interests and access involves application of Exemption 4 to the universe of information covered by Subsection (a)(3).[299]

A narrower area of conflict involves the more limited universe of information covered by subsection (a)(2),[300] which provides: "To the extent required to prevent a clearly unwanted invasion of personal privacy, an agency may delete identifying details when it makes available or publishes an opinion, statement of policy, interpretation, or staff manual or instruction." Privacy and confidentiality are preserved by striking identifying details and confidential information prior to releasing the document; the other portions of the order or opinion must be made available. The privacy proviso contains limitations: "However, in each case the justification for the deletion shall be explained fully in writing."

Protection of commercial information from access under Exemption 4 of the FOIA[301] is important to the electronic release policy options available to agencies.[302] Exemption 4 shields from FOIA access records that constitute trade secrets, or confidential commercial information. If a trade secret is involved, Exemption 4 applies without further factual inquiry.[303] Even if a trade secret is not involved, Exemption 4 nevertheless may apply if the information is commercial in character *and* the agency can demonstrate that its release either would impair the agency's ability to obtain similar information in the future, *or* that release of the information would cause substantial competitive harm to the person supplying the information.[304]

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[296] The concluding sentence of 5 U.S.C. §552(b) says, "Any reasonably segregable portion of a record shall be provided to any person requesting such record after deletion of the portions which are exempt under this subsection."

[297] 5 U.S.C. §552(b)(6).

[298] 5 U.S.C. §552(a)(3) residually covers all agency "records."

[299] *See also* Chrysler Corp. v. Brown, 441 U.S. 281, 319 n.49 (18 U.S.C. §1905, barring disclosure of trade secrets, may trigger Exemption 3, exempting information specifically exempted from disclosure by statute).

[300] 5 U.S.C. §552(a)(2) covers final agency opinions, adjudicatory orders, "statements of policy and interpretation" not published in the Federal Register, and certain administrative staff manuals and instructions.

[301] 5 U.S.C. §552(b)(4).

[302] *See* §V(F)(4)(a),

2 *Federal Register Act*

The Federal Register Act[305] requires that certain categories of information having binding effect on agencies and regulatees be published in a form accessible to the public in general. Although this Act does not specifically address information in electronic form, its policy would be served by electronic release systems that make covered information available to a broad segment of the public. The Act gives the Administrative Committee of the Federal Register authority to set prices to be charged for the Federal Register without reference to general profit margins required for the sale of other government publications.[306]

3 *Access fees: User Fee Act*

The User Fee Act[307] sets general guidelines for establishing user fees for government services. Basically, these guidelines say that services or things of value provided by an agency to a person should be self-sustaining through user charges. The statute requires the charges be "fair" and based on four factors:

— costs to the government,

— the value of the service or thing to the recipient,

— public policy or interest served, and

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[303] Public Citizen Health Research Group v. FDA, 704 F.2d 1280, 1286-87 (D.C.Cir. 1983) (trade secret for FOIA Exemption 4 purposes is an unpatented commercially viable plan, formula or process used for making, preparing, or processing of articles which are trade commodities).

[304] Public Citizen Health Research Group v. FDA, 704 F.2d 1280, 1290-91 (D.C.Cir. 1983).

[305] 44 U.S.C. §1505.

[306] 44 U.S.C. §1504.

[307] 31 U.S.C. §9701 (1982).

— other relevant facts.[308]

The Act authorizes agencies to issue regulations establishing charges, subject to policies prescribed by the President.

4 *Privacy Act*

The Privacy Act,[309] codified as part of the Administrative Procedure Act, obligates agencies to restrict access to "systems of records" concerning individuals and to provide access to such information to the individuals covered. The Privacy Act is concerned with information maintained in electronic form and imposes a duty to design electronic databases to facilitate response to individual requests and to safeguard against non-permitted access.

The Privacy Act interacts in some important ways with the Freedom of Information Act. The Privacy Act is concerned with "systems of records"[310] within which information is kept on individuals.[311] The Act was primarily motivated by concern over computerized databases,[312] but it is broadly applicable to paper as well as electronic information.

The Act limits access to information within a system of records,[313] ensures that individuals have access to records about them,[314] permits agencies to establish regulations restricting access to systems of records covered by FOIA Exemption 1[315] or to law enforcement activities or federal employee evaluation,[316] and otherwise specifically prohibits agency reliance on any FOIA exemption to withhold from an individual information pertaining to her.[317]

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[308] 31 U.S.C. §9701(b).

[309] 5 U.S.C. §552a.

[310] 5 U.S.C. §552a(a)(5) (defining "system of records"). The Act does not cover informal records which may pertain to individuals. Boyd v. Secretary of the Navy, 709 F.2d 684 (11th Cir. 1983) (supervisor's memorandum of meeting with employee, not keyed to employee's name or identifying number), cert. denied, 104 S.Ct. 709, 79 L.Ed.2d 173.

[311] The Act does not, for example, cover databases oriented toward economic regulation of commercial enterprises. Unt v. Aerospace Corp., 765 F.2d 1440 (9th Cir. 1985) (letter about employer rather than employee); Fagot v. Federal Deposit Ins. Corp., 584 F.Supp. 1168 (D.P.R. 1984) (records organized by bank name).

[312] *See* Thomas v. United States Department of Energy, 719 F.2d 342 (10th Cir. 1983).

[313] 5 U.S.C. §552a(b).

[314] 5 U.S.C. §552a(d).

5 *The Paperwork Reduction Act*

The Paperwork Reduction Act[318] is the most comprehensive of the enumerated statutes. It contemplates formulation of a government-wide information policy by a new Office of Information and Regulatory Affairs within the Office of Management and Budget.[319] Building upon the longstanding requirement that agencies seeking to collect information obtain OMB approval, the Act expressly mentions electronic information techniques and obligates the Director of OMB to develop government wide policies for coordinating data acquisition requests, data use, and information systems acquisition policies.[320] In several places, the Act reinforces obligations imposed by the Privacy Act and directs that Paperwork Act authorities be exercised so as to promote attainment of the duties imposed by the Privacy Act.[321] The Act provides that no person shall be subject to penalties for failing to provide information under an agency requirement not conforming to the Paperwork Act's procedures.[322]

Although the Paperwork Reduction Act gives new authority to OMB over federal information policy, it also expressly foreswears any broadening of OMB authority over substantive policies and programs of agencies,[323] and leaves intact other statutory provisions limiting OMB's authority to determine the need for specific services or to conduct procurement.[324]

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[315] *See* §V(B)(1) .

[316] 5 U.S.C. §552a(k).

[317] 5 U.S.C. §552a(q).

[318] 44 U.S.C. §§3501-3520 (Supp. 1986).

[319] 44 U.S.C. §§3503-3504.

[320] 44 U.S.C. §3504.

[321] 44 U.S.C. §3501(6) (policy), §3504(g) (OMB functions).

[322] 44 U.S.C. §3512.

[323] 44 U.S.C. §3518(e); *See* Steelworkers v. Pendergrass, 855 F.2d 108 (3d Cir. 1988) (OSHA hazardous communication standard not within OMB Paperwork

Unfortunately, the Paperwork Reduction Act is drafted in general terms and, although it refers to electronic information management techniques,[325] its provisions dealing with the clearance process are focused more directly on paper reports.[326] It does, however, clearly cover the full range of information acquisition activities[327] whether voluntary, required to obtain a benefit, or mandatory.[328] The only apparent acquisition exclusion is for agency information acquisition regarding a particular target of an investigatory or enforcement action.[329]

Only in section 3504(g)(4)[330] does the Act address information release. This provision is not well integrated with the other provisions of the act.[331]

OMB has released draft guidance for comment, intended to

Reduction Act authority).

[324] *See* 41 U.S.C. §405(c).

[325] 44 U.S.C. §§3501(5) (policy); 3502(2), 3502(13), 3504(a), 3504(g) (OMB functions), 3505(1)(C) and (E), 3506(c)(6).

[326] But see S.Rep. 96-930, 96th Cong., 2d Sess., reprinted in 1980 U.S.CODE CONG. & ADMIN. NEWS 6241, 6253 (Paperwork Reduction Act applies to SEC electronic acquisition).

[327] Certain activities are exempt, such as criminal investigations, civil litigation, those relating to intelligence or cryptologic activities. 44 U.S.C. §3518(c)(1).

[328] 44 U.S.C. §3504 (c)(2)(C) (requiring information request to inform the public which of three characterizations applies).

[329] *See* Cameron v. IRS, 593 F.Supp. 1540 (N.D.Ind. 1984), *aff'd*, 773 F.2d 126; United States v. Particle Data, Inc., 634 F.Supp. 272 (N.D.Ill. 1986).

[330] (OMB shall promote ADP and telecommunications equipment to improve dissemination of data.)

[331] *See* Sprehe, *Developing Federal Information Resources Management Policy: Issues and Impact for Information Managers*, 2 INFO. MANAGE. REV. 33, 37 (1987) (contrasting explicit statutory policy direction for information acquisition with lack of such policy direction for dissemination).

implement the Paperwork Reduction Act.[332]

6 *OMB Circular A-130*

OMB is authorized to set information policy by the Paperwork Reduction Act,[333] the Privacy Act,[334] the Federal Property and Administrative Services Act,[335] the Budget and Accounting Act of 1921,[336] and Executive Order 12046.

Circular A-130 mandates that public rights to access information derived from the FOIA be preserved in electronic release systems.[337] OMB has directed that agencies should place "maximum feasible reliance on the private sector" for the dissemination of information.[338] OMB does not intend that agency information activities "be indiscriminately turned over to . . . the private sector," but intends that agencies have an obligation to examine private sector activities before embarking on duplicative activities of their own.[339] OMB recognizes:

> Over time, changes in laws, economic conditions, or information technology can result in changes in public demand, public purpose, or dissemination costs; for example, an agency's shift to electronic filing of reports, perhaps carried out primarily in order to improve internal information management, might generate a public demand for electronic dissemination that could be satisfied at minimal cost to the government and also improve the performance of the agency's information access function.[340]

Agencies should, according to OMB, consider the most cost-effective way of proceeding, considering both availability of private sector means of distributing information and the inherently governmental character of certain information functions.[341]

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[332] *See* §V(B)(6).

[333] 44 U.S.C. §3304.

[334] 5 U.S.C. §552a.

[335] 40 U.S.C. §759.

[336] 31 U.S.C. §1 et seq.

[337] Para. 7(g), 50 FED.REG. at 52736.

[338] OMB Circular A-130 at 8.a.(11)(b), 50 FED.REG. 52730, 53736 (Dec. 24, 1985).

[339] 50 FED.REG. at 72746 (Appendix IV to Circular A-130).

[340] 50 FED.REG. at 52547 (Appendix IV to Circular A-130).

Circular A-130 has been criticized as being too deferential to the private sector, and the language "maximum feasible reliance" might seem to warrant the criticism.[342] But the explanatory text recognizes that cost/benefit factors may militate in favor of an active government role to disseminate information related to an inherently governmental function,[343] or to disseminate information electronically when such dissemination has major benefits and de minimus costs resulting from technology developed to meet internal agency needs.[344] The most reasonable reading of the Circular is that it requires consideration of existing or potential private sector electronic products and mandates evaluation of the relative costs and benefits of public versus private dissemination activities, not that it erects an artificial bar to government electronic dissemination when private sector products exist.

Moreover, the Circular expressly recognizes the appropriateness in some cases of government action, though contract, or otherwise, to constrain unreasonably high prices charged by private sector resellers of government information with a monopoly position.[345]

In these respects, A-130 is entirely consistent with the process envisioned by Recommendations B through E.

In August, 1987, OMB released for public comment proposed policy guidance on electronic collection of information.[346] The proposed policy requires agencies to certify that they have considered use of electronic information collection techniques as a means to reduce burdens on respondents and costs to the government. When final, this guidance will be issued as an appendix to OMB Circular No. A-130. The purpose of this policy guidance is, first, to cause agencies systematically to take account of potential management efficiencies derivable from electronic information collection, and second, to ensure that agencies consider the major legal and policy issues that arise in connection with such collection. OMB suggested the following specific guidelines:

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[341] 50 FED.REG. at 52748 (Appendix IV to Circular A-130, explaining continuing validity of Circular A-76 regarding public/private roles).

[342] Para. 8(a)(11)(B), 50 FED.REG. at 52736.

[343] Appendix IV, 50 FED.REG. at 52748, discussing requirements of Circular A-76.

[344] Appendix IV, 50 FED.REG. at 52747, discussing paragraph 8(a)(9)(B).

[345] Appendix IV, 50 FED.REG. at 52748, discussing paragraph 11(a).

[346] 52 FED.REG. 29454 (Aug. 7, 1987).

1. General Policy. For all collections of information subject to the Paperwork Reduction Act, agencies shall certify when submitting the information collections for OMB approval, that they have considered use of electronic collection techniques as a means to reduce burden on respondents and costs to the government.

2. Feasibility of Electronic Information Collection.

a. Agencies should examine their information collection to determine whether conditions favor the electronic collection of information. Conditions favorable to electronic collection include:

(1) The agency routinely converts the information collected to electronic format;

(2) A substantial proportion of respondents are known to possess the necessary information technology and to maintain the information in electronic form;

(3) Conversion to electronic reporting, if mandatory, will not impose substantial costs or other adverse effects on respondents, especially small business entities;

(4) The information collection seeks a relatively large volume of data and/or reaches a large number of respondents;

(5) The information collection is relatively frequent; i.e., annually or more frequently; and

(6) The content and format of the information sought by the information collection does not change significantly over several years.

b. Where most of the foregoing conditions are present, electronic collection may be advantageous, and agencies should conduct benefit-cost analyses to determine whether the benefits of electronic collection, including dollar savings and reduction in paperwork burden, outweigh the capitalization and other costs both to the government and to respondents.

c. Where agencies determine that benefits outweigh costs, they should actively pursue the design and development of electronic collection systems.

3. Design and Development

a. In designing and developing electronic information collecting systems, agencies should ensure that records subject to the Privacy Act, and information permitted to be exempted from access under the Freedom of Information Act or any other legislative or regulatory provision, are adequately and properly protected.

b. Agencies should avoid designing and developing electronic collection systems in which private sector contractors are expected to pay for the costs of governmental functions associated with systems.

c. Agencies should consider private sector capabilities for performing cost benefit analyses and in the design, development, and implementation of electronic information collection systems.

d. In designing and developing an electronic information collection system, agencies should consult regularly with the likely respondents to the information collection and try to accommodate their suggestions.

e. Where mandatory electronic reporting is imposed, agencies should develop procedures permitting waiver from electronic reporting for those respondents who may incur unreasonable costs.

f. Where agencies plan to disseminate electronically the information collected electronically, they should design and develop systems so as to integrate collection and dissemination into the same systems insofar as possible.

g. Where electronically collected records are subject to access under the Freedom of Information Act or are to be made publicly accessible for any other reason, agencies should provide for such access in the design and development of the collection system.

h. Agencies should incorporate records management and archival considerations in the design, development, and implementation of electronic information collection systems in accordance with the Federal Records Act[347]

These guidelines are entirely consistent with Recommendations B, D, and E.

7 *Department of Commerce Draft Guidelines*

On August 5, 1988, the Assistant Secretary of Commerce for Administration published a draft departmental administrative order containing policies for electronic dissemination of information.[348]

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[347] 44 U.S.C. §§29, 31, and 33.

The draft is intended to implement OMB Circular A-130 within the Department of Commerce. Much of the draft reiterates guidance from Circular A-130,[349] but certain portions provide additional guidance warranting separate comment in this section. The draft distinguishes between "new" dissemination products and products that merely change from paper to electronic media the form in which information is disseminated.[350] New products are those increasing the amount or types of information, changing the amount or types of audiences, changing the frequency of dissemination, or changing the speed of dissemination.[351] The draft defines wholesaling and retailing.[352]

The draft mandates use of private sector resources for electronic dissemination when the value to be added is best performed by the private sector,[353] or when the private sector will provide faster delivery to users or lower costs.[354] These criteria for allocating responsibility between public and private sectors are similar to those suggested by Circular A-130 and in Recommendation D of this report, but the Commerce Guidelines put them in mandatory terms.

A more singular feature of the Commerce guidelines is that they make use of the private sector mandatory when further dissemination primarily benefits non-federal users.[355] This mandate apparently would not permit Commerce agencies to compare costs and benefits to the public of various mixes of public and private activities when the benefits of electronic dissemination are largely private. This is significantly different from the cost/benefit analysis recommended in Recommendation D.

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[348] The August 5 draft is referred to hereinafter as "Commerce Guidelines".

[349] *See* §V(B)(6).

[350] The draft uses the distinction in formulating its requirements for public notice about electronic dissemination products.

[351] Commerce Guidelines §5.02(c).

[352] The definitions are quoted in §V(F)(2) of this report.

[353] Commerce Guidelines at §6.02(c)(1).

[354] Commerce Guidelines §6.02(c)(3)-(4).

[355] Commerce Guidelines §6.02(c)(2).

A separate section of the draft, setting standards for agency management approval of electronic information products, apparently precludes approval of products that envision adding value, though the phrasing and placement of the "no value-added" standard is cryptic.[356] If this criterion is meant to preclude dissemination products containing any added value, it would prevent making the benefits of the byproducts of internal automation available to the public.

8 House Government Operations Committee Policy Report

In 1986, the Committee on Government Operations published a policy statement on electronic dissemination.[357] The policy statement is not, of course, an authoritative expression of policy for the Congress as a whole. It presents, however, a thoughtful analysis, and is one of the few governmental documents that explores the appropriate directions for government-wide electronic information policy.

The House policy statement encourages agencies to expand public availability of electronic information,[358] but also urges that agencies avoid unnecessary competition with the private sector in disseminating electronic information.[359] "Fair competition" should be the criterion for agency deference to private sector electronic dissemination.[360] Fair competition, as explained by the policy statement, means the following:

1. Agencies should use modern technology to improve the range and quality of public access to agency records.[361]
2. Agencies should support a diversity of information distribution

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[356] Commerce Guidelines §9.02(g).

[357] Committee on Government Operations, House of Representatives, *Electronic Collection and Dissemination of Information by Federal Agencies: A Policy Overview*, H.R.Rep. 99-560, 99th Cong., 2d Sess. (1986) [hereinafter "House Policy Report"].

[358] House Policy Report, *supra* note 124, at 9-10.

[359] House Policy Report, *supra* note 124, at 2.

[360] House Policy Report, *supra* note 124, at 59-61.

[361] House Policy Report, *supra* note 124, at 11 (Recommendation A(1)).

mechanisms.[362]

3. Agencies should not provide nonessential services to the public simply because the capability to provide the service exists or because the marginal cost of providing additional services is low.[363]
4. Agencies should limit services they provide to the public in order to leave the private sector to provide additional value added services.[364]
5. When paper records are replaced by electronic databases, agencies should provide public access to the electronic databases.[365]
6. Agencies should not provide electronic storage or electronic mail services (except for communication with the agency) in conjunction with electronic dissemination.[366]
7. Agencies should act so as to encourage private enterprise to add value to electronic information so that it may be sold at a profit, even if this means artificially limiting the agency's electronic dissemination role.[367]
8. Agencies should avoid arrangements that give themselves or private companies any monopoly power over electronic data.[368]

The Report also encourages advance notice to Congress, potential contractors and user communities, and full compliance with laws and regulations covering acquisition of automated data processing equipment and services and federal procurement generally.[369]

Although the enumerated "Recommendations" in the report emphasize preserving a role for the private sector, the entirety of the report and its enumerated "Findings" make it clear that agencies should use electronic methods to advance public availability of agency information, and that some degree of competition between public and private sectors with respect to information products is inevitable.

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[362] House Policy Report, *supra* note 124, at 11 (Recommendation A(2)).

[363] House Policy Report, *supra* note 124, at 59.

[364] House Policy Report, *supra* note 124, at 59-60.

[365] House Policy Report, *supra* note 124, at 60.

[366] House Policy Report, *supra* note 124, at 60.

[367] House Policy Report, *supra* note 124, at 61.

[368] House Policy Report, *supra* note 124, at 61.

[369] House Policy Report *supra* note 124,at 11-12..

C. Security Issues

Three slightly different security questions are raised by electronic acquisition and release systems. First, do electronic communications links between agency databases and members of the public intended for acquisition or release of information increase the likelihood of unauthorized access to information possessed by the agency? Second, does keeping information in electronic form make it more likely that agencies will make errors in screening information in response to FOIA requests, thereby failing to afford the protections contemplated by the exemptions to the Freedom of Information Act or by the Privacy Act? Third, do such systems increase the possibility that information required by the government could be lost, because of transmission errors, accidental erasure, or deterioration of electronic media?

Many important and difficult information security issues are beyond the scope of this report.[370] Agencies may have inadequate precautions to protect information against disaster such as fires or floods. They may have inadequate personnel screening and supervision practices. They may not have appropriate backup or archiving procedures for electronic information. But these risks to information security exist regardless of whether agencies undertake electronic acquisition or release.[371] The proper scope of inquiry for this report is to identify those aspects of electronic acquisition or release programs that change the risk of information loss or improper access. As to those risks, agencies must include appropriate security procedures as an integral part of their systems designs.[372]

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[370] *See* 41 C.F.R. §§201.7.000-201.7.205 (1987) (security of federal information resources, obligating agencies to ensure security of electronic information systems); U. S. Congress, Office of Technology Assessment, *Defending Secrets, Sharing Data: New Locks and Keys for Electronic Information* (1987) (OTA-CIT-310) (examining vulnerability of communications and computer systems and trends in technology for safeguarding information in such systems).

[371] *See generally Is Your Computer Secure?*, BUSINESS WEEK, Aug. 1, 1988, at 64 (describing risks to government computer systems).

1 *Unauthorized Access*

It is well accepted that expanding the points of access and the class of persons entitled to access to any electronic information base increases the risk of unauthorized access. The unauthorized access problem is illustrated by a recent incident with ACS[373] in which electronic mailboxes were mixed up by Customs personnel, resulting in some brokers receiving information intended for other brokers and a limited amount of confidential enforcement information not normally made available outside the agency. The same kind of error can occur with paper systems; a clerk can put documents in the wrong envelope. But it is also true that directing information electronically to the wrong destination may escape detection longer, and a single error might result in much larger quantities of information being misdirected.

In some cases, of course, the problem disappears because the entire information base is public. This is true of the SEC EDGAR information, and the three tariff systems discussed in this report.

An additional layer of protection is possible in electronic acquisition systems. Users can supply information to the system, but not be permitted to obtain information from the system except for acknowledgment messages. The security problem is more difficult with respect to electronic release systems because their very nature contemplates user access to portions of the information base defined by the user to be of interest.

A major subspecialty of information systems technology involves development of appropriate compartmentalization, passwords and other access-limiting methods to ensure that users can obtain access only to those data to which they are entitled.[374] Acquisition and release systems should be designed to include state of the art access control techniques.

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[372] *See* OMB Circular A-130, Appendix III, 50 Fed.Reg. 52730, 52742 (Dec. 24, 1985) (requiring agencies to assure adequate security for all agency automated information systems).

[373] *See* §III(C).

[374] *See generally* H.Perritt, How to Practice Law With Computers ch. 8 (1988); Computerworld Focus, Apr. 6, 1988 (special issue on computer security and disaster recovery).

It should be noted that the highly publicized danger of computer "viruses" is not an issue with agency electronic acquisition and release systems because viruses inhabit executable computer programs, not data. None of the systems considered in this report involve electronic transfer of program code as opposed to data.

2 *FOIA/Privacy Act Screening*

The FOIA and Privacy Act screening problem[375] is different in kind but not in character from the same problem arising in connection with an FOIA request for paper records. Paper records pertaining to an FOIA request generally are reviewed by an FOIA officer of the agency. Information protected by the Privacy Act or potentially covered by an FOIA exemption is identified and the agency forms a position as to whether the confidential information can be redacted from the paper record or whether the entire record must be withheld.

The same kind of screening process can take place with electronic records. FOIA officers can review the requested information on video displays or on paper printouts. The screening problem may be more difficult with electronic information, however. Pressure is growing for agencies to supply information in electronic form, possibly retrieved via computerized database query methods.[376] Except for the need for screening, individual records or fields comprising such information would not be presented to agency personnel in a form that a human can read. So the need for FOIA and Privacy Act screening interposes a step for human intervention that otherwise would not be necessary.

Hopefully, as more experience is obtained, automated techniques can be developed and perfected that will improve the quality of Privacy Act and FOIA exemption screening. For example, the Customs Service presently redacts certain manifest information to ensure that shippers and consignees entitled to protection from access under the Customs statutes have identifying information redacted from their manifest records.[377]

In some cases security is better with electronic systems. Once a computer screening program is correct, it will block confidential data with absolute reliability. File clerks are not so reliable. It is not unheard of for a clerk to send the wrong pile of paper, sending confidential information to persons supposed to receive only the nonconfidential information.

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[375] *See* §V(F)(4)(a)(v), discussing electronic "redaction."

[376] *See* §III(B).

[377] *See* §III(C).

3 *Loss of Information*

The third type of security problem will arise with paperless electronic acquisition systems. It has not yet become manifest because two of the most mature acquisitions systems, EDGAR and ACS, presently require information to be filed in both electronic and paper form. The paper filing is the official one. Loss of data apparently is not a problem with the IRS electronic filing system, where no parallel paper records exist.

Eventually, however, parallel paper and electronic channels will be eliminated. Then, what happens if the agency seeks to impose sanctions on a person for failing to file and the person defends on the grounds that a filing was submitted but the agency lost it?

It certainly is true that electronic data can be erased quickly, leaving no trace unless some audit system is in place. This possibility seems to make a failure-to-file dispute especially difficult to resolve in the case of electronic filing. But the difficulty can be put in better perspective by considering the same problem in a purely paper system. Government agencies do lose paper forms. In such a case, the burden of proof presumably is on the filer. The filer is unable to meet this burden unless it has some documentary or testimonial evidence of the filing.[378] There is no reason that such evidence is harder to come by with respect to electronic filing than paper filing. Both EDGAR and ACS provide electronic receipts, and so does the IRS automatic filing system.

One theoretical possibility for mitigating the risk of lost or altered data is for an electronic acquisition system to write a duplicate copy of all received filings to a special "log" file, separate from the files intended for subsequent agency processing, which would be protected from alteration or manipulation.[379]

The increasing availability of practicable optical disk storage facilitates creation of such a log file. Because the CDROM type of optical disk technology is inherently inalterable, electronic receipts can be written to CDROM as soon as they are received, creating a permanent record of the filing. The electronic receipts stream then could be routed to agency analysts for further processing without concern about maintaining an audit trail of alterations

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[378] Many filers of paper forms have the agency file-stamp duplicate copies of the paper filing. Such a procedure makes meeting the filer's burden of proof easy.

[379] The author appreciates Dallas attorney Benjamin Wright's suggesting this possibility.

D. Cost/Benefit Analysis

One proxy for a social welfare criterion for agency electronic information activities is a favorable cost/benefit ratio. Agencies generally are obligated by OMB policy to undertake cost/benefit analyses before they begin new automation projects.[380] In addition, procurement regulations require than funds sufficient for commitment under an eventual contract be available in advance.[381] Until bidders make offers with price estimates, however, an agency may lack reliable cost estimates. Moreover, the benefit side of the analysis is difficult because some government information has benefits that are not economic.[382]

The best approach is to recognize that different kinds of information have different kinds of benefits to different consumers; and to enumerate those advantages—non-economic as well as economic, also enumerating the marginal costs of providing electronic information in different ways, through private sector as well as public sector channels. Long-term costs and benefits should be considered as well as short term marginal costs. A short-term marginal cost analysis may lead to a conclusion that an agency should retail information as a byproduct of its internal automation activities; yet long-term software enhancement, and communications system expansion capital costs may be great.

In addition to capital and operating costs,[383] agencies should consider unrecovered costs associated with existing government or private sector capital that would be obsoleted by the new product, and capital and marginal costs to consumers of substitute sources of information if the product is launched but not maintained or funded to permit its intended benefits to be realized over its planned term.

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[380] *See* OMB Circular A-11 §43.2 (c).

[381] *See* 48 C.F.R. §15.402(d) and Subpart 32.7; 41 C.F.R. §201-32.103.

[382] *See* 50 FED.REG. 52730, 52732 (Dec. 24, 1985) (preamble to OMB Circular A-130) (discussing comments to proposed draft); Recommendation E

[383] *See* Recommendation E.

Benefit assessment should include cost avoidance associated with eliminating the cost of producing existing paper products, eliminating agency and consumer costs of making and responding to paper FOIA requests, eliminating agency and consumer costs of retrieving information from and maintaining public reference rooms. Benefits also should include the increase in the number of interested persons having access to information, and improvements in the utility of information for its intended purpose because of improved organization and retrieval possibilities, or reductions in delays associated with transferring information from an agency to eventual consumers

In designing electronic databases, agencies should consider explicitly the types of FOIA requests likely to be received for data in the database. Insofar as it is consistent with agency mission performance, databases should be designed so as to facilitate, or at least not to impede, FOIA access. The rule of thumb should be that it should not be any more difficult for FOIA requesters to obtain data after automation than before. In some cases, effective design, motivated by responsiveness to agency missions, or by making information effectively available electronically to a wider spectrum of the citizenry, will require some sacrifices in FOIA retrieval capability. In these cases, agency designers should consider how FOIA requests can be satisfied consistent with the spirit of the Act. This might militate toward budgeting for higher costs of satisfying FOIA requests that should not be shifted to requesters because it would increase the cost of searches above costs of paper retrieval. Or, it might involve making raw data available on magnetic or optical disk to requesters along with retrieval software so that requesters can massage the data and effect their own retrievals.

In other cases, new electronic information products may reduce costs, to both requesters and agencies, of FOIA requests. This would occur, for example if certain information were published electronically or disclosed electronically in a public reference room rather than only through a paper FOIA request.

E. Electronic Acquisition Policies

1 *Policy Issues*

The major policy issues[384] relating to electronic acquisition of information are:

- Should filers be permitted to file electronically even if filing is not mandatory?
- When should electronic filing be mandatory?
- If filers are required to file electronically, what should be the policy for waiving this requirement?
- How can electronically filed documents be authenticated?

Electronic acquisition presents significantly less controversy than electronic release for several reasons. Most electronic acquisition programs in operation or advanced planning make filing voluntary. SEC's EDGAR and FMC's tariff system are exceptions. Apparently difficult format compatibility problems are being worked out with relatively little difficulty so far. Agencies are working through private sector intermediaries where they exist.

a. Permissive and mandatory filing

In some cases, filers have information in electronic form but are not permitted to file it electronically. Perhaps the clearest example involves international air cargo and passenger tariffs which currently are filed electronically by airlines with one of two contractors, the Official Airline Guide or Air Tariffs Incorporated.[385] These contractors produce hard copies of the electronically filed information, and file the hard copies with the regulatory agencies.

The only real issue with respect to voluntary electronic filing relates to the cost of an agency having two separate tracks for receiving information; one electronic and one a paper process. Additionally, of course, all of the compatibility issues associated with mandatory filing are involved in voluntary filing except that an agency presumably has more discretion to impose requirements for the format of voluntarily filed information. The IRS, FMC, Customs Service and SEC have resolved format questions without major controversies.

Mandatory electronic filing requirements must balance benefits to the agency, the public, or the regulatees from electronic filing against the costs of imposing such requirements. In some cases, such as the international air tariff example discussed above, the cost to most regulatees is small. But in most instances, there will be some regulatees that would be unable to meet mandatory electronic filing requirements without buying electronic conversion services, particularly when small businesses constitute part of the filing community.

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[384] Other controversies, raising legal and technical issues, are discussed later in the report.

[385] *See* §III(I).

It may be essential to provide for some kind of exception to the mandatory requirement so that some filers can file on paper. But storing some information only in paper form undermines the integrity of the resulting computerized database, and agencies should undertake the burden of keying information that is filed in paper form. An additional danger of waiving the electronic filing requirement for too many filers is that some filers may be tempted to file on paper to serve illegitimate ends, such as delaying release of information to the public so that financial gain can be made from the information "float."

In some cases, the burdens of electronic filing can be mitigated by relying on commercial intermediaries to put the information in an electronic form that is acceptable to the agency. There is some precedent for this approach in the tariff area. For decades, tariff bureaus have assisted small transportation enterprises in meeting the filing requirements imposed by the Interstate Commerce Commission and other regulatory agencies. The broader and more diverse the filing population, however, imposing filing requirements legally and then effectively obligating persons to use commercial services to access their government agencies can engender significant controversy. Most agencies considering the question, such as IRS and the Customs Service, have let filing be voluntary but have tried to create incentives for filers or third parties to file electronically. This is a good approach, if the incentives work.

The population of the filer community for the IRS is so large that the Service is relying on aggressive marketing to third-party intermediaries to expand electronic acquisition. The Customs Service similarly is relying on inducements for voluntary participation. Even when the burden of mandatory electronic filing is substantial, filers may be induced to support such a mandatory requirement if they get access in electronic form to data that is of interest to them. This has been an important inducement in the Customs Service Automatic Custom Service database. Port authorities must spend approximately $100,000 for hardware necessary to file electronically, but they have been relatively eager to do so because by participating, they get access to the filings in electronic form.

b. Signatures on filings

A concern often expressed about electronic filing programs is that an electronic filing, unlike a paper filing, cannot be signed in the usual way. This concern is considerably overblown. A number of techniques exist to satisfy any legal requirement for a signature on electronic filings.

It is important to be clear what a "signature" is. Under generally accepted definitions, a signature is any mark made by a person intending that the mark be that person's signature.[386] Under this definition, a signature need not be holographic;[387] it need not spell out the signer's name; there is no conceptual reason why the "mark" cannot be an electronic string of symbols rather than the image made by ink on paper.

Before considering the particular approaches taken by federal agency electronic filing programs, it is appropriate to note that the American banking industry has found electronic signature methods acceptable for use with automatic teller machines to withdraw money from bank accounts[388] even though non-electronic withdrawal procedures usually require traditional holographic signatures on paper.

Signature requirements for electronic acquisition systems raise many of the same issues as telegraphic signatures. Disputes over the validity of telegraphic signatures historically have been resolved by imposing a duty on the recipient of a telegram to verify the validity of the signature.[389]

Two basic approaches are being used by federal agencies to meet signature requirements. The SEC's EDGAR system exemplifies the first approach. The IRS electronic filing project exemplifies the second. EDGAR filings are accepted only when the filer transmits two different codes, an access password, and a signature code. The second of these codes is assigned in a way, and filers are expected to use it in a way, that limits its availability to persons authorized to "sign" SEC filings.

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[386] *See Signatures*, 80 C.J.S. 1284, at §§2,7 at 1286, 1287 (1953 & Supp. 1987).

[387] *See id.*, §7 at 1294-95, citing Zenith Radio Corp. v. Matsushita Electric Indus. Co., 505 F.Supp. 1190, 1224 (E.D.Pa. 1980).

[388] *See* generally Electronic Fund Transfer Act, 15 U.S.C. §§1693a-1693r (allocating responsibility for economic loss between banks and depositors and providing for contractual regulation of details).

[389] Cf. Bradford Trust Co. v. Texas American Bank, 790 F.2d 407 (5th Cir. 1986) (validity of telegraphic signature not directly in question; reviewing legal principles and cases).

Electronic tax returns must be followed by a simple paper submission that has a holographic signature.

Despite the efficacy of these two approaches, some concerns about electronic signatures, or paper signatures validating separately-transmitted electronic forms, are appropriate. These concerns arise because of the possibility that the signer of an electronic form would take the position that the information actually received by an agency is not the same information that the signer signed.

One concern is that the electronic filing might be misdirected and never reach the agency. This possibility is not appreciably different from the possibility that a mailed paper form would be misdelivered and never reach the intended agency. A variety of confirmation and character count approaches, such as those used by the Customs Service, IRS and EDGAR systems, are appropriate to minimize this risk.

Another concern is that an electronic form would be transmitted to the correct agency but only partially received. This is a risk that exists to a lesser extent with a paper form: while paper submissions arrive at agencies with missing pages from time to time, the omission usually is obvious. It is appropriate that agencies receiving electronic forms establish character count checks to ensure that if an entire electronic form is not received that none of it will be accepted and that the sender will get a rejection notice.

The third concern is that the content of an electronic form would be garbled in the transmission. This also is unlikely with the paper form. This risk is harder to manage, though appropriate error checking both in the communications link,[390] and in the database acceptance software, can reduce the risk.

In any event, an electronic log, discussed in §V((C)(3), can be maintained on non-erasable media, which, if used in conjunction with state-of-the-art error checking protocols, should provide ample evidentiary support for what an agency received electronically.

2 *Legal Issues*

Legal issues associated with mandatory filing requirements are most likely to turn on interpretation of specific statutory authorization for agencies to require the filing of information. For example, could the Securities and Exchange Commission legally require persons to file information electronically, before enactment of the 1987 EDGAR legislation? Do the organic statutes of economic regulatory agencies bear an interpretation that permit them to require tariffs to be filed electronically? The FMC, for example, explored this question, and obtained a legal opinion answering the question affirmatively.

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[390] *See* §III(B)(2).

A slightly different question occurs in connection with statutes that give members of the public a right to submit information. A clear example is section 553 of the Administrative Procedure Act giving members of the public a right to submit comments on proposed agency rules. If an agency were to require that comments be filed electronically, the legal question would be whether the burden of electronic filing impermissibly interferes with the right to file comments and have them considered by the agency. FERC does require that regulatory filings be electronic.[391]

F. Electronic Release Policies

Several policy issues exist with respect to electronic release of information. The policy issues must be understood in the context of three different levels of electronic release, specifically including:

(1) release of electronic information only in bulk, or only in response to FOIA requests. This is the lowest level, corresponding to "access," in the taxonomy suggested in the introduction to this report.[392]

(2) release of electronic information only through public terminals in public reference rooms. This is an intermediate level, corresponding to "disclosure" in the taxonomy.

(3) electronic publishing, involving on-line, dial-up links or sale and distribution of magnetic or optical disks formatted so as to permit easy retrieval on a small computer. This is the highest level, corresponding to electronic publishing or "dissemination" in the taxonomy.

While the dividing lines among the three levels are subject to disagreement, more value has been added to the raw electronic information as one moves from the lowest level to the higher levels,[393] and the higher levels more accurately can be described as retailing information, while the lower levels can be described as wholesaling information.[394]

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[391] *See* §III(D).

[392] *See* §II(A)(3) for an explanation of the distinctions among dissemination, disclosure and access.

Most of the controversy over every program discussed in this report involves the question whether the sponsoring agency should publish (disseminate) information electronically, as opposed only to providing access under the FOIA or offering disclosure through public reference room terminals. Controversy also exists regarding the legality of agencies' restricting access to electronic information. In most cases, agencies legally are obligated only to provide access or to disclose, not to disseminate, information. Moving to higher levels of release is largely discretionary.

Releasing agency information electronically through dialup links, or sale of tapes or disks offers significant benefits to consumers of the information who have the technology to use it in electronic form. When more value is added to the information, in the form of structured data elements, indexes and retrieval software, the broader the base of information consumers who can benefit. But agencies are not the only ones who can offer these benefits. Many private sector enterprises pioneered dialup links to large databases containing large amounts of government information. Deciding the respective roles of public and private sectors is at the heart of most of the controversy over agency electronic release programs. Private sector electronic information vendors fear that disseminating agencies may compete unfairly with private sector entrepreneurs. Such unfair competition could result from agencies' offering value added services to the general public at prices supported by public funds.

The major electronic release issues are (1) pricing,[395] and (2) retailing versus wholesaling.[396] Even lower release levels, not involving publication or dissemination, engender controversy. As Sections V(F)(1) and V(F)(4)(b) explain, electronic FOIA access, and certain types of electronic reference room disclosure can alter materially the competitive conditions for electronic marketing of agency information. The issues are influenced strongly by a related set of legal issues, involving questions over user fees,[397] intellectual property rights,[398] and Freedom of Information Act obligations.[399]

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[393] *See* §V(F)(1).

[394] *See* §V(F)(2).

[395] *See* §§V(F)(3) and V(F)(4)(b)

[396] *See* §§V(F)(2) and V(F)(4)(a)(vi).

For any of the three types of information release,[400] the policy issues do not change when an agency works through a contractor as opposed to providing access itself. The contractor may act just like the agency, providing access to the entire universe of information, providing equal access, providing timely access, and not imposing economic barriers to access higher than the agency itself would erect. On the other hand, agencies may seek to structure contractor relationships to give the contractor a preferred position in reselling agency information.

1 *Information as an Economic Good: Adding Value*

Information is an important economic good. But an immutable characteristic of tangible economic goods—scarcity—applies only in diminished form to information. Information can be shared indefinitely without depriving the original owner of anything. Moreover, information usually can be duplicated relatively cheaply. Electronic information can be duplicated even more cheaply than paper information. As a result of these characteristics, it is difficult to set a high price on information unless secondary distribution can be prevented. Copyright is a standard legal mechanism to restrict duplication and secondary distribution.[401] Government information cannot be copyrighted, but government agencies can exert a variety of controls that prevent certain forms of electronic release and therefore limit the cheapest forms of duplication and redistribution. Such restrictions permit either the agency or an outside possessor of the electronic information to enforce a high price because such an agency or outside possessor has a monopoly in the marketplace for that information.

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[397] *See* §V(F)(4)(b).

[398] *See* §V(F)(1).

[399] *See* §V(F)(4)(a).

[400] Access, disclosure, dissemination. *See* §II(A)(3).

[401] The foregoing observations come from House Policy Report, *supra* note 124, at 24.

Electronic information shares many of the qualities of paper information. But the nature of the value that can be added to electronic information differs in magnitude from roughly analogous forms of value added to paper information. Other characteristics of electronic information, besides susceptibility to cheap copying, influence the economics of such information.

Paper information is immediately usable by ultimate consumers. Electronic information is not; it requires a computer with appropriate software to interpret the information and present it on a screen or print it on paper. Large quantities of raw electronic information are not very valuable because it is difficult for computers to retrieve particular information items of interest to an information consumer. Structured information with indices and matching retrieval software is highly valuable, however, because any data item accommodated by the structure can be retrieved easily. Telecommunications links, or availability on disks appropriately formatted for use on personal computers increases the value further.

Compiling paper information and adding indices increases the value of the information somewhat; structuring electronic information and adding retrieval software adds to its value enormously. Paper information must be possessed physically to be used. Electronic information can be transmitted over telecommunications links. So creation of appropriate telecommunications links is a type of value that can be added to electronic information with no counterpart in the paper information world.

"Adding value" to electronic information means adding structure, indices and retrieval software to the raw data and adding telecommunications links to the data or distributing personal computer diskettes with the resulting enhanced data on them.

Developers of electronic information systems have strong motives to create monopolies, but the points at which monopolies can be created differ for electronic information, depending on the points at which significant value can be added. Significant capital may be required to convert information to electronic form and to develop and operate systems for storing, managing and retrieving the information. If the investor of the capital releases the enhanced information without restriction, it is possible for other persons to duplicate and distribute it at very low marginal costs thereby undercutting a price sufficient to afford recovery of capital costs. These characteristics of electronic information as an economic good create strong incentives for the first person who creates an electronic database to restrict duplication and redistribution. This is true whether the person creating the electronic information base is an agency or a private sector entrepreneur.

Private sector entrepreneurs will be willing to produce government information products only if they have a reasonable expectation of recovering their costs (including capital costs) and can earn a reasonable rate of return. If the government sells the same information products at or below cost, the government will drive the private sector out of the market, or prevent it from entering the market. Firms already selling government information in electronic form fear inexpensive government dialup links because that could permit consumers to bypass private sector services.

Agency sale of raw data in electronic form does not compete with vendors offering value added retrieval and telecommunications capability, but it may make it easier for private sector competitors to enter the market because it eliminates the cost of keying paper information.

User fees enter into the economic equation. Low user fees for bulk raw electronic information benefit private sector competitors who do not already have information in electronic form. Low user fees for value added information directly competes with existing value added vendors. High user fees, of course, have the opposite effect.

But there also can be a reversal of the roles these economic facts would suggests. Opponents of wide public dissemination through government electronic systems understand that low or no user fees probably mean no public disclosure because of competing demands for public funds. Interests desiring wider public disclosure probably understand the same thing. Accordingly, there is a tendency for political role reversal to occur, present vendors siding with Congress in favor of low or no user fees, and the potential information consumers siding with OMB in favor of user fees.

2 Retailing versus Wholesaling: Public/Private Sector Roles

Permeating all three levels of information release is the question of whether federal agencies should retail information in electronic form or only wholesale it. Retailing means disclosing or disseminating directly to the general public, and providing search and retrieval software and other added value. Wholesaling means providing information to large volume requesters or contractors only in raw form, relying on the recipient to package it and resell it to the general public.

Agency retailing makes the agency a competitor of private sector sellers of electronic information. Agency wholesaling makes the agency a supplier of private sector sellers, and a possible promoter of additional competition in private electronic information markets.

The August 5, 1988 draft Department of Commerce order covering electronic information dissemination provides useful definitions of retailing and wholesaling:

> *Wholesaler*: An information provider who transmits information only as provided by the government or only in bulk form.
>
> *Retailer*: An information provider who obtains government information by reformatting, analyzing, aggregating or segregating subsets, enhancing search or retrieval capabilities, or otherwise tailoring it to be of value to specialized end users.[402]

A clear example of wholesaling is the release by the Government Printing Office of tapes of Federal Register and Congressional Record text which then is repackaged by West Publishing Company and Mead Data and made available to the general public (at substantial cost) via the WESTLAW and LEXIS databases, which include sophisticated search capability. The Federal Register and Congressional Record in printed form, however, are obvious examples of government retailing of paper information. MEDLARS[403] and the Commerce Department economic bulletin board[404] are the clearest examples of electronic information retailing.

As noted in the preceding section, many different kinds of value can be added by an information retailer. Most common is the construction of an inverted index, necessary to permit key word search and retrieval of information from a free text database.[405] A retailer also may sell a total package of communications links and database access.[406] A retailer may offer one-stop shopping so that an information consumer can gain access to information from many different agencies through what appears to be a single database.[407] A retailer may offer useful topical groupings of information or proprietary classification systems.[408] A retailer may reformat information so that it can be fed into an ultimate consumer's computer system.[409]

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[402] Commerce Guidelines §5.02(f).

[403] *See* §III(M).; House Policy Report at 59 (noting the practical unlikelihood of terminating MEDLARS, despite industry opposition).

[404] *See* §III(O).

[405] *See* §II(B)(3).

[406] WESTLAW is an example. A subscriber to WESTLAW need not make special arrangements with a Public Data Network in order to access the database via a local telephone gateway.

The commentary to Recommendation D offers a further distinction between "manufacturing" and "distributing" certain value added features. Value-added features such as data structures, indices and search and retrieval software may be manufactured as a byproduct of automating internal agency functions. Distributing these features to the public, however, requires further investment which may be performed more cost effectively by the private sector.

At present, administrative agency dissemination policies are being driven toward wholesaling and away from retailing by the desire of private sector information providers to protect markets, combined with congressional desire for control over the purse strings.

OMB Circular A-130, the Commerce Guidelines and the House Policy Report all encourage agency wholesaling and discourage agency retailing of value-added electronic information.

Present policy seeks to mobilize market forces to ensure availability of information at a price no greater than distribution costs. If a vendor charges too much money, new entrants will drive down the price. Agencies should not, according to these concepts, frustrate market forces by protecting markets for information to create a monopoly for their own automated system, or to protect markets for contractor systems. The easiest way for an agency to create a monopoly for its own, or a preferred vendor's electronic retailing service is to refuse to release electronic information in any form, or to release it only in very small quantities or only in inconvenient places, frustrating potential competitors' ability to use it.[410]

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[407] Compuserve, ABA/net, WESTLAW and LEXIS are good examples.

[408] West's key number indexing system is a good example.

[409] ATP's formatting of airline tariff information for inclusion in airline reservation systems is a good example.

[410] *See* Computaprint v. U. S. Department of Commerce, discussed in §III(F) (complaint alleging inadequacy of access to USPTO reading room

It is not accurate to conclude that the government historically has not added value to information and retail the resulting information product. For many years the Supreme Court has published United States Reports, containing syllabi, headnotes, and chronological compilations of Court opinions, rather than restricting itself to releasing slip opinions, and letting private sector enterprise add headnotes and publish compilations as occurs with courts of appeals opinions. United States Reports is retailed through stores maintained by the Superintendent of Documents throughout the country, as well as by mail order. The United States Code is another value added product, organizing statutes to facilitate retrieval, rather than simply releasing Statutes at Large. The Code of Federal Regulations represents another value added product, aimed at facilitating user access to agency rules. If the government were to restrict itself to a wholesaling role, it would simply release agency decisions, or perhaps publish the Federal Register, and leave it to private entrepreneurs to compile the rules.

In each of these three examples of paper information products, a policy decision has been made by the Congress or by the Court, that the public interest requires the added value at government expense.

A similar range of examples exists in the universe of electronic release products. The Department of Commerce retails information through its electronic bulletin board. GPO wholesales bulk electronic information only. USDA has designed a value-added system to encourage wholesale use and to discourage retail use.

Making government information decisions depend on existing private sector activity is controversial because it may result in establishing artificial policy-based restrictions on government dissemination of public information in order to protect private markets. Yet, questions also exist about the appropriateness of duplication of services: if a private company distributes government information widely, in a highly usable format, at affordable prices, why should public resources be used to provide a duplicative service, even if it is just as good a product? An example familiar to most lawyers illustrates the appropriateness of such a policy in at least some circumstances. The government does not publish the opinions of the United States Courts of Appeals in a form readily usable by persons using them for legal

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terminals to build comprehensive electronic database of patent and trademark files).

research. Rather, the courts publish individual slip opinions and leave it to the private sector to compile the opinions into paper and electronic products readily usable by lawyers. West Publishing Company publishes the opinions in a series called Federal Reporter Second, which is treated by lawyers and courts as the official source of judicial precedent from this level of court. In addition, West Publishing and Mead Data publish the opinions electronically in their WESTLAW and LEXIS databases. No apparent benefits would result from the federal courts deciding to publish a competing set of court of appeals opinion reporters in paper; nor would there be apparent benefits from the federal courts' undertaking to publish the opinions electronically. Costs to the court system and to West and Mead would increase if such government competition were to occur. This conclusion would change only if some new computer technology should evolve and be widely available to the consumers of this information and the existing opinion publishers did not embrace the new technology for some reason.

Nor should agencies discourage market entry by "dumping" information products at prices lower than those necessary to encourage private capital investment. Private sector entrepreneurs produce government information products only when they expect to recover their total costs and earn a reasonable rate of return. If the government prices essentially the same information products at a level below the price necessary for private sector cost recovery, the government will drive the private sector out of the market, or prevent it entering the market. A comprehensive information policy must address the possibility that the agencies possessing information would undercut prices charged by entrepreneurs in a competitive market.

Other concerns also exists about too great a public sector role in information retailing. The government might drive the private sector out of a particular market, achieving a practical monopoly, and then provide inferior service because of funding limitations. In other words, an assessment of short-run marginal costs might support a conclusion that the government should retail information, driving the private sector out of the market, but longer term public finance concerns might turn the government's information product into something inferior to what the market would produce on its own. The government may be less responsive to competitive forces than private sector providers, resulting in lower efficiency and lower overall social welfare. When the government is the sole conduit for important public information, warranted or unwarranted suspicion can be fueled that the information is subject to political manipulation. Of course such suspicions can arise when the information is maintained and released solely in paper form as well.

In striking an appropriate balance between retailing and wholesaling, it is essential to understand that the two types of electronic release are not mutually exclusive: the government might retail to some degree but also wholesale to private sector information resellers who would create retail information products different from those offered by the government. For example, the government can release bulk electronic information on tapes or optical disks in combination with public reference room disclosure. It is a valid policy goal for the government to act so as to promote diversity in information products and pricing. This policy may be pursued more effectively if the government limits its role than if it occupies the market.

But the free market model does not always fit the realities of the electronic information marketplace. The most important assumption for a theoretical free market to operate efficiently is relatively free entry. In fact there are substantial barriers to entry, some capital, some technological. These barriers to entry create an industry structure closer to oligopoly than perfect competition. This is consistent with current observed pricing behavior. Simply saying that the federal government should wholesale and not retail is not enough to ensure market efficiency.

Agencies can design their electronic release information products to promote competition. In some cases, the cost/benefit assessment proposed in Recommendations D & E will conclude that market inefficiencies and pricing levels represent barriers to adequate levels of public availability. In such cases, agencies may compete themselves by offering and distributing retail electronic information products. This may be an attractive alternative, for example when the significant added value is the byproduct of internal agency automation.[411] More often, agencies should design their electronic release systems so that wholesale products reduce costs for private sector electronic information resellers, and encourage new private sector entrants.

Depending on how an agency makes information available, the barriers to adding further value or to using it directly can be small or great. For example, if an agency releases information only on magnetic tape or only on diskettes in the IBM EBCDIC format the economic barriers to accessing this information whether for ultimate consumption or for adding value and resale, are much greater[412] than if the agency simply makes the information available on a dialup telephone line or in ASCII format on floppy diskettes.[413] But offering *only* dialup links impedes adding value because dialup disclosure is inherently interactive, although a value added retailer needs to obtain large quantities of data in a batch transfer.

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[411] For many years, the centerpiece of Australian air transportation policy was to promote competition between one national airline and one private airline. Obviously factors influencing airline policy are entirely different from factors influencing electronic information policy. Australia's Two Airline Policy, however, illustrates how a government may deliberately enter a market to create competitive forces that might otherwise be absent.

Moreover, it is difficult technologically to draw a clear line between retailing and wholesaling of information without artificially restricting disclosure of computerized information. In many cases, absolutely restricting an agency to a wholesaling function is artificial. The wholesaling concept implies that agencies release only raw data, and not add value in the form of indices, retrieval software, or dial-up telecommunications disclosure. In virtually every case, however, an agency must develop retrieval software and indices in order to make use of the raw data internally. The costs of these two types of added value will already have been absorbed by the agency. Restricting the agency from making these indexes and retrieval software available to the public therefore erects an artificial barrier to public access in order to protect private markets. Moreover, as §V(F)(4)(a)(iv) explains, it is not altogether clear that either indices or retrieval software in electronic form can be protected from access under the Freedom of Information Act. The distinction between "manufacturing" and "distributing" electronic information products, reviewed *supra* in this section, provides a way to deal with this reality while preserving a private sector role.

Software necessary to permit public disclosure of computerized information at a public disclosure terminal represents substantial added value to the database.[414]

Dialup links via telecommunications lines are another matter. The sophistication and cost of a telecommunications interface for an agency database varies in proportion to the number and dispersion of persons seeking access. Rarely would an agency construct a telecommunications access for its own internal use of data anywhere near as large as would be needed for widespread public disclosure.

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[412] The barriers are greater to ordinary individuals or small businesses, not to sophisticated computer programmers.

[413] Of course it also can make it available in formats suitable for persons wishing to process large quantities of information.

[414] *See* §V(F)(1).

In addition to electronic disclosure through public reference room terminals, agencies should provide bulk electronic release options rather than one document at a time, or retrieval only through menus.[415] Dialup connections bias release toward end-user retailing unless the information is time sensitive. A system providing only 1200 or 2400 baud transfer rates, and no high speed dedicated links, bulk tapes or CDROMS is biased in favor of end-user dissemination and against wholesale dissemination to resellers. Conversely, a system that concentrates on dedicated lines, tapes and CDROMS is biased toward wholesaling to resellers and against end-user dissemination.

Accordingly, as the commentary to recommendation D suggests, it is prima facie appropriate for agencies to add value, and thus to retail, to the extent of making publicly available their own retrieval software and indices. They should, however, also make data available in a form that will facilitate private sector development of different or better retrieval methods and indexes.

And, as the commentary to recommendation D suggests, it is prima facie appropriate for agencies not to undertake large scale public disclosure telecommunications interfaces unless (1) there is reason for believing that the private sector will not provide such disclosure, (2) disclosure via depository libraries will not be sufficient in terms of the scope of information available through those intermediaries or in terms of delays before it will be available, or (3) the nature of the information places it in the highest category warranting public expenditure to make it widely available.

3 *Pricing*

As §V(F)(4)(b) explains, the law is flexible enough to allow agencies considerable discretion in setting prices for information products.

Within the framework, policy choices regarding public/private sector roles, especially the retailing/wholesaling distinction, can be implemented through pricing structures. High fixed charges (subscription, access or monthly charges), combined with low variable charges (per document or character retrieved and downloaded) benefit high volume users such as resellers and create economic barriers for low-volume end users. Conversely, low fixed charges, combined with high variable charges, benefit low-volume end users and penalize high volume resellers. So if a dissemination system is aimed primarily at wholesaling, it should have high fixed, and low variable, prices. Examples are the National Weather Service and USDA EDI systems.

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[415] *See Computaprint*, §III(F), supra.

A collateral benefit of attractive pricing for resellers is discouraging use of the FOIA as an end run around the agency-preferred release product, because it is cheaper to get large quantities of electronic information through the preferred channel.

An evaluative process for making these pricing policy choices is presented in §V(F)(4)(b) and summarized in Recommendations D & E.

4 *Legal Issues*

a. Freedom of Information Act issues

The growing use of computer technology to store, access, and communicate information raises a number of issues under the Freedom of Information Act ("FOIA"), APA §552:[416]

- Is information possessed by the agency in electronic form—on tape, magnetic disks, or optical media—a "record" within the meaning of §552(a)(3)?
- If it is, must the agency make it available in the form in which it is kept? Conversely if such electronic information would be difficult for a requester to access, must the agency transfer it to paper media? As more and more opinions, orders, policies, interpretations, manuals, and instructions are kept in electronic form, does §552(a)(3) require that such documents be made "available for public inspection and copying" in paper form, or may they be made available for public inspection and copying in electronic form, via computer access devices?
- If agencies must make electronic records available in electronic form, must they make available internal software or programming services to retrieve information according to the request? If they must, who pays the cost and how should it be calculated?
- How should privacy and proprietary commercial interests be protected when information is made available in electronic

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[416] *See* §V(B)(1) for an overview of FOIA.

form?

- Does FOIA impose a limit on agency policy decisions only to wholesale electronic information?
- How do the Federal Register publication requirement of §552(a)(1), the Federal Register Act, and §553, apply to notices and rules maintained and actually published electronically?

A large number of agencies maintain a growing portion of their records in electronic form, in databases, electronic typesetting files, or word processing document files. The economic and administrative incentives are great to expand the use of technology, reducing the maintenance of paper records. The treatment of such electronic information under the catch-all records access requirements of §552(a)(3) already has produced some controversies that have reached the courts.

It is not appropriate for agencies to frustrate FOIA access by automating. Nor is it appropriate for FOIA requesters to dominate the design of database schemes, the allocation of programmer resources, or to force agencies to perform sophisticated statistical analysis or data comparisons. Unavoidably, a period of experimentation will be necessary as new concepts under the FOIA are developed that fit the nature of electronic information and retrieval technology.[417]

The scope of agency access obligations under 5 U.S.C. §552(a)(3)[418] is limited by the definition of "record" and by two conditions precedent. Whether "record" includes information kept in electronic form is addressed later in this section. The two conditions precedent are the two criteria a requester must meet before an agency must provide access. The first requirement is that the request be for identifiable records, obligating the requester reasonably to describe the desired records.[419] This description should be specific enough so that "a professional employee of the agency who was familiar with the subject area of the request [could] locate the record with a reasonable amount of effort."[420]

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[417] *See* Yeager v. DEA, 678 F.2d 315, 327 (D.C.Cir. 1982) (FOIA must be contoured to characteristics of computer records).

[418] Subsection (a)(3) excludes records made available under (a)(1) and (a)(2).

[419] 5 U.S.C. §552(a)(3)(A).

[420] H.R. Rep. No. 876, 93d Cong., 2d Sess., 5-6 (1974).

If a request does not reasonably describe the desired records or is too indefinite, the Act does not mandate an open-ended search by the agency and the request may be denied.[421]

Second, the request must comply with the published rules and procedures of that agency.[422] This second, rule-compliance, requirement influences electronic FOIA concerns because agency rules are the means by which fee requirements are imposed. Section 552(a)(3)(B) requires agencies to promulgate rules setting uniform fee schedules, establishing only those fees necessary to cover the "direct costs" of "searching" and "copying."[423]

If both prerequisites are satisfied and the request does not fall within any of the nine exemptions, the agency must provide access.

In 1986, the FOIA was amended to authorize agencies to prescribe fee schedules for three levels of agency activity: document duplication alone; search time, and review time.[424] The agency fees must conform to uniform fee guidelines issued by OMB.[425] Commercial requesters can be charged for review time, search time and duplication;[426] most other requesters can be charged for search time and duplication;[427] and a limited category of requesters can be charged only for document duplication.[428] OMB promulgated a uniform FOIA fee schedule,[429] which, among other things, explicitly covers computer searches "using existing programming,"[430] defines duplication to include making machine readable documentation including tapes and disks,[431] and establishes a costing method for computer searches for records.[432] The OMB guidelines[433] not only help apply FOIA fee concepts to automated records; they also imply that the FOIA covers records kept in computer-readable form.

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[421] *See e.g. Electronic Memories and Magnetics Corp. v. United States,* 431 F. Supp. 356 (C.D. Cal. 1977) (request for Customs Service opinions insufficiently specific).

[422] 5 U.S.C. §552(a)(3)(B).

[423] 5 U.S.C. §552(a)(4)(A).

[3] Freedom of Information Reform Act of 1986, 100 Stat. 3207, 3207-48 (1986), amending 5 U.S.C. §552(a)(4)(A).

[4] 5 U.S.C. §552(a)(4)(A)(i).

[5] 5 U.S.C. §552(a)(4)(A)(ii)(I).

[6] 5 U.S.C. §552(a)(4)(A)(ii)(III).

[7] 5 U.S.C. §552(a)(4)(A)(ii)(II) (education and non-commercial scientific organizations and news media).

[429] 52 Fed.Reg. 10012, 10017 (1987).

[430] 52 Fed.Reg. at 10017 (Para. 6(d)).

i. Is an electronic document or record an FOIA "record?

The prevailing view now is that computer stored information is considered an agency record under FOIA just the same as paper documents.[434]

In *SDC Development Corp. v. Mathews,*[435] the court of appeals in an opinion written by now Supreme Court justice Kennedy, held that MEDLARS information[436] did not constitute "records" or "agency records" required to be made available at nominal charges under the Freedom of Information Act. The court found that the information was not primarily of the type intended to be covered by Freedom of Information Act access requirements and also found a conflict between FOIA access and fulfillment of the statutory mandate of the National Medical Library.[437]

But there is growing agency acceptance of the proposition that information kept in electronic form is a "record."[438] The House Policy Report sharply criticizes the *SDC Development Corp.* holding.[439] The

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[431] 52 Fed.Reg. at 10017 (Para. 6(e)).

[432] 52 Fed.Reg. at 10018 (Para.7(b)).

[433] 52 Fed.Reg. 10012, 10017 (1987).

[434]. *See Long v. IRS*, 596 F.2d 362, 365 (9th Cir. 1979), *cert. denied*, 446 U.S. 917, 100 S. Ct. 1861, 64 L.Ed.2d 271 (1980).

[435] 542 F.2d 1116 (9th Cir. 1976).

[436] *See* §III(M).

[437] 542 F.2d at 1120.

[438] *See* Yeager v. Drug Enforcement Administration, 678 F.2d 315, 321 (D.C.Cir. 1982) (computer stored records, whether stored in central processing unit, on magnetic tape or in some other form are FOIA "records"; agency not obligated to compact information to satisfy request).

[439] House Policy Report at 33.

OMB FOIA fee guidelines[440] imply that the FOIA covers records kept in computer-readable form. The Veterans Administration has proposed amendments to its regulations permitting public access to legal opinions of the agency's general counsel maintained on the general's counsel's computerized database.[441] A recent conference of state freedom of information act administrators resulted in agreement that "a variable definition of public record based on the medium in which the information is stored is unacceptable," and that computerized records should be considered to be "records."[442] Recommendation A proposes that agencies not rely on *SDC Development Corp.*, instead treating electronic data as FOIA records. Otherwise the FOIA will be nullified as more and more agency information is kept in electronic form.

ii. Who chooses between paper and electronic access?

A second question is whether an agency can refuse to provide access to information in computer form because it is readily available in some other form from the agency or from a third party. Many agencies take the position that, even when information is requested in electronic form, the agency has the discretion to insist upon disclosing it in paper form. Conversely, there may be other instances in which requesters want the information in paper form, especially individuals or small businesses, but an agency wishes to provide access to it only in electronic form.

Dismukes v. Dept. of the Interior[443] directly addressed an agency holding records in two separate forms. In *Dismukes*, the Department of the Interior denied an FOIA request for a copy of a computer tape listing of the names and addresses of participants in a Federal oil and gas lottery, instead offering the requested information on microfiche, which was the usual medium for dissemination. The dispute was not whether the computer tape constituted an agency record, but whether a request for information on computer tape could be satisfied by the release of the same information on microfiche.

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[440] 52 FED.REG. 10012, 10017 (1987).

[441] *See* 53 FED.REG. 8471, 8472 (Mar. 15, 1988).

[442] 1 Public Records Division, Office of the Massachusetts Secretary of State, Report of the First National Conference on Issues Concerning Computerized Public Records 17 (1987). [hereinafter "State FOIA Report"].

[443]. 603 F.Supp. 760 (D.D.C. 1984).

The court conducted a two part analysis in deciding this issue. First, the court considered whether a requester could designate the format of the information. Because the FOIA deals with the content of information, not its form, the court held that a requester does not have an absolute right to designate the format of the information as long as the variation in format does not reduce the quantum of information available to that requester.[444] The court concluded that the information would be the same, whether provided on computer tape or on microfiche; therefore, the quantum of information available in either form was not reduced by limiting the requester to microfiche.

Second, the court considered whether the release of information in a form other than that requested would unreasonably hamper plaintiff's access to that information.[445] The court found that even though the microfiche was slightly more expensive than the computer tape, it was a satisfactory alternative because it was most useful to the general public, and did not erect unreasonable barriers to plaintiff's access to the information. The agency need only provide information in a "reasonably accessible" form.[446]

By negative implication from *Dismukes*, an agency might violate the FOIA by declining to provide computer readable forms of information when the alternatives forms are significantly more difficult for the requestor to use. Conversely, if the quantum of information is the same in computer and non-computer media, and if the non-computer medium is reasonably accessible, *Dismukes* says the disclosing agency need not release the information in electronic form.

The *Dismukes* facts apply to agencies which possess information in more than one form, but does not deal directly with an agency's right to deny the release of information because it is publicly available outside that agency. The D.C. Circuit Court in *Tax Analysts v. United States Dept. of Justice*,[447] answered this question in the negative. In *Tax Analysts*, the Justice Department denied plaintiff's request for district court tax decisions, claiming that they were already publicly available for inspection and copying almost immediately upon issuance from the issuing court. Although court access was alleged by plaintiff to be inadequate, the lower court refused to shift to the DOJ the administrative burden and expense of supplying copies of the tax decisions.

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[444] *Id.* at 762.

[445] *Id.*

[446] *Id.* at 763.

[447] 845 F.2d 1060 (D.C. Cir. (1988).

The D.C. Court of Appeals, in reversing, concluded that district court tax decisions must be made available by the DOJ upon a proper FOIA request. It held that the availability of the same information outside the agency does not relieve the agency of its duties under FOIA.

The holdings in *Dismukes* and *Tax Analysts* provide a helpful framework when information is available in both electronic form and some other form. If it is the agency that holds the information in two or more forms, a *Dismukes* analysis is applied by comparing the utility and content similarity of the different forms. *Dismukes* also is relevant when an FOIA request covers information contained both in a structured database and in unstructured free text. The requester might prefer one or the other depending on whether the requestor has software to take advantage of the database structure.

If, on the other hand, both an agency and a third party[448] hold the same information, the *Tax Analysts* holding mandates that the agency release its information, assuming it constitutes an agency record.

Exemption 5 of the FOIA[449] is interpreted as incorporating certain concepts from federal civil discovery rules.[450] Those discovery rules have been interpreted as compelling, in response to a "request for production of documents,"[451] the disclosure of information in computerized form.[452] The same logic should apply to the requirements of §552(a).

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[448] For example, a value-added reseller of electronic information supplied by the agency.

[449] 5 U.S.C. §552(b)(5).

[450] *See* NLRB v. Sears, Roebuck & Co., 421 U.S. 132, 149 (1975) (exemption 5 interpreted as basically coextensive with civil discovery exclusions). Just because Exemption 5 is analogous to privileges in civil discovery does not mean that there is a policy rationale for a more general borrowing of civil discovery concepts for interpreting other FOIA exemptions. But there is no clear reason why electronic information should not be covered by both the civil discovery obligations and the FOIA.

[451] *See generally* Advisory Committee Note to F.R.Civ.P. 34 (1970 Amendments; rule 34 applies to electronic data compilations).

[452] *See* Williams v. DuPont Co., ___ F. Supp. ___, 45 F.E.P.Cases (BNA)

Indeed the indexing requirement of that section might be served better by an electronic index then by paper indices.

FOIA case law suggests that the Freedom of Information Act is intended to make information available to the public without unduly burdening requesters. It is consistent, therefore, with the spirit of the Act to interpret it to require an agency to make information available in electronic form when that would not burden the agency greatly and when it would burden the requester to handle a paper or other non-electronically accessible form of the information.[453] Conversely, because the purpose of the FOIA is to make information available, a requester unable to read electronic information almost certainly would be entitled to the information in some kind of form that the requester could read. There is no obvious reason, however, why this requirement might not be satisfied by presenting the desired information on a video display device, as long as the requester could make a "copy"—perhaps through a co-located printer.

Agencies should permit FOIA requesters to specify whether they want records in electronic or paper form, recovering any disparate costs of satisfying requests for particular media from the requester. If information normally is kept in electronic form and the requester wants it on paper, it ought to be sufficient if the agency provides a public terminal with an attached printer.[454] To follow *Dismukes* can deny the public the benefits of information technology.

One must recognize that permitting FOIA requesters to specify media creates a potential end run around the wholesale/retail policy choices made by an agency,[455] but it is most appropriate to deal with that problem through (1) design of access and dissemination products, and (2) the relative pricing of access/dissemination products to make

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887 (W.D.Ky 1987) (compelling EEOC disclosure of database even though original information in possession of requestor; denying discovery of copyrighted data manipulation software; citing other cases).

[453] Strictly speaking information on an optical disk is not in electronic form, but it is electronically accessible.

[454] But see *Computaprint*, discussed in §III(F) (plaintiff allegations that use of public terminal is unduly burdensome way of obtaining information).

[455] *See* §V(F)(4)(a)(vi).

those products more attractive than FOIA access.[456]

iii. Fees for "programming"

A significant controversy exists with respect to applying the FOIA's user fee limits[457] to electronic information.

Assuming that electronic information comprises a "record" covered by the FOIA, such information in its raw form rarely is useful. For example, modern database systems organize individual records to meet the needs of the hardware. Ordering and selecting information of interest to a user depends upon sophisticated query formulation, optimization, and retrieval techniques. A useful automated information system makes available such software to agency personnel. If an outside person requests information, however, use of agency software, and frequently a certain degree of programming, is necessary to retrieve information corresponding to the request.

In some cases, such retrieval requires little more than formulation of a single query in the query language of the database. Arguably, this is programming, but arguably it is not. At the other extreme, an FOIA requester might desire data sorted and retrieved according to complex and unanticipated criteria, necessitating extensive programmer hours to satisfy the request. Some agencies take the position that no FOIA request need be satisfied if any programming is required to satisfy the request. The rationale for this position is that the FOIA does not obligate agencies to create records, but only to provide access to existing records. Other agencies are willing to perform the programming, or to make available agency software, but refuse to cover the full cost of such programmer or software availability. Litigation is presently underway between Public Citizen Inc. and OSHA on these issues.

It is important to understand that certain legal analytical concepts developed to apply the FOIA to paper records may not be appropriate in applying it to electronic records. The need for "programming" to satisfy FOIA requests is a good example.

It is easy to understand what it means to create a new paper record. It is harder to know what it means to create a new electronic record. Is retrieval programming a "search", in which case the agency is obligated to do it, or is it creation of a new record, in which case the agency is not obligated to do it. Is selecting a dozen records meeting criteria defined on a single screen menu a "search"? Is it programming? Is it generating a new record? Intuitively, this is not "programming," nor is it generating a new record. Is a statistical analysis of the underlying data "generating a new record", a "search", or is it "programming"? Intuitively this seems like programming or creating new information.

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[456] *See* §V(F)(3) for a discussion of the impact of pricing on FOIA end runs.

[457] *See* §V(F)(4)(a) (introduction), for a description of how the FOIA limits fees.

Some retrieval systems, especially on older mainframe database technology, require an activity that legitimately could be called "programming" to retrieve anything. Under such systems, a certain amount of "programming" would be required to respond to any FOIA request. Other systems, employing newer relational database technology, Query-By-Example software, and menuing approaches, permit new types of information as well as traditional "records" to be retrieved simply by selecting a menu choice and pressing a key. It is more desirable to charge requesters the actual costs of retrieval, or provide them with retrieval hardware, software and documentation,[458] than to decline FOIA requests for electronic information because they require "programming" or generating new records.

iv. Access to indices and software

As §V(F)(4)(a)(i) explained, there is growing acceptance of the idea that electronic data is an FOIA "record."[459] However, an issue still bitterly unresolved is whether coding schemes, computer programs, and computer indices must be made available as FOIA "agency records."

Although there are no decisions to date that explicitly resolve this question, several cases provide guidance as to the legal framework for considering the issue.

The first question is whether software and indices are FOIA "records." Assuming the electronic form of the underlying data is a record,[460] there is no apparent reason why software and indices are not records also.[461]

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[458] Recommendation C(3) encourages agencies to consider the costs and benefits of upgrading FOIA disclosure to access through reading room terminals.

[459] *Long v. IRS*, 596 F.2d 362, 365 (9th Cir. 1979), *cert. denied*, 446 U.S. 917, 100 S. Ct. 1861, 64 L.Ed.2d 271 (1980)

[460] *See* §V(F)(4)(a)(i).

The second issue is whether an agency may deny an FOIA request for database indices or program code under Exemption 4 as a trade secret or commercial information.[462] This issue is determinative of whether a federal agency can avoid access to indices or other software designed by a private developer. *In Re Inslaw*[463] involved a debtor's effort to establish its proprietary interest in computer software and to enjoin the Department of Justice from "appropriating its interest," in part by releasing it under the FOIA. The debtor, Inslaw, had contracted with the DOJ to develop software connected with the PROMIS system. A dispute arose when the DOJ asserted ownership of enhancements to the PROMIS system added by Inslaw on Inslaw's own initiative, paid for with its own funds.

In negotiations between DOJ and Inslaw over the allocation of property rights in the software, DOJ took the position that the enhancements were covered by its contract with Inslaw and DOJ would therefore consider FOIA requests for the software.[464] Earlier however, DOJ had rebuffed a FOIA request for PROMIS programming code and software documentation on the grounds (1) that they were "trade secrets and commercial or financial information obtained from a person and privileged or confidential," and thus exempt from access under Exemption 4 of the FOIA, and (2) that release of the information was prohibited under 11 U.S.C. § 362(a), the automatic stay in bankruptcy proceedings. Under the second argument, the FOIA request for software could have been denied under Exemption 3, which prohibits the release of information protected by a statute other than 5 U.S.C. § 552.[465]

The bankruptcy court concluded that, because Inslaw's software enhancements were proprietary and a trade secret, the Department of

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[461] *See* Windels, Marx, Davies & Ives v. Department of Commerce, 576 F.Supp. 405 (D.D.C. 1983) (computer program to evaluate steel import prices would be disclosable but for qualification under Exemptions 2 and 7).

[462] *See* §V(B)(1) for a discussion of Exemption 4, and the standards applicable for deciding if a trade secret or other protectable commercial information is involved.

[463]. 83 B.R. 89 (D.D.C. 1988).

[464]. 83 B.R. at 153, 155.

[465]. *Id.* at 155, n.29.

Justice could not copy, use, sell or disseminate the software.[466]

The threat by DOJ to release the PROMIS software upon an FOIA request was never litigated because the software enhancements were not the property of the Justice Department, and thus could not be "agency records" covered by FOIA access obligations. Additionally, the earlier DOJ denials of FOIA requests under Exemptions 3 and 4 were never contested by the requester, so it is unclear as to how a reviewing court would have ruled on the soundness of DOJ's FOIA decisions.

Inslaw is not an FOIA case, but the opinion does offer several conclusions of law useful to FOIA analysis: (1) computer programs can be trade secrets;[467] and (2) trade secret protection for a private government contractor is not lost when the contractor licenses the program to the government.[468] Unless trade secrets do not qualify for protection under Exemption 4 of the FOIA—an unlikely proposition,[469] *Inslaw* is support for the idea that an FOIA requester would not be entitled to FOIA access to contractor-developed software as to which the contractor has retained intellectual property rights under its license to a government agency. Moreover, mere possession of a document does not necessarily mean that it is an agency "record" subject to FOIA access.[470]

The strongest argument for an obligation to provide access to indices and retrieval software would be: (1) such information constitutes an "agency record;" (2) the information is not a third party's trade secret or confidential information within Exemption 4.[471] Under *Dismukes*, the agency could provide access either in paper form or in computer readable form, assuming a listing of the indices and program code is reasonably usable by the requester in either form.

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[466]. *In Re Inslaw*, at 159.

[467] 83 B.R. at 158 (citing cases).

[468] 83 B.R. at 159 (citing cases).

[469] *See* Public Citizen Health Research Group v. FDA, 704 F.2d 1280, 1286-87 (D.C.Cir. 1983) (trade secrets protected by Exemption 4 without further inquiry).

[470] *See* Center for National Security Studies v. Central Intelligence Agency, 577 F. Supp. 584, 586 (D.D.C. 1983) (copy of Congressional document in agency files not an "agency record").

[471] *See* §V(B)(1) for an explanation of the standards for deciding if Exemption 4 applies.

The strongest argument against access would be that the indices and other software were developed by a third party which retained an intellectual property interest, such as copyright, or trade secret, in it. A somewhat weaker argument would be that the "agency record" is the underlying data, and the indices and other software are unnecessary to make the underlying data reasonably accessible; in other words, the indices and software do not themselves constitute an "agency record".

Many of these issues are before a district court in the *Computaprint* case, discussed in §III(F), specifically whether computerized compilations constitute an FOIA record, whether availability of electronic disclosure on public reference room terminals relieves an agency of an FOIA obligation to provide access to the contents of a database in bulk electronic form, whether contractor proprietary interests in database software can prevent FOIA access under Exemption 4, and whether FOIA access can be prevented by contract.

v. Protecting privacy interests

An important FOIA issue is how privacy interests recognized both by FOIA Exemption 6 and the Privacy Act should be protected when information in electronic form is requested.[472] One can characterize this as an "electronic redaction" problem.

If information is covered by FOIA Exemption 6 and is also in a Privacy Act system, the Privacy Act eliminates the agency's discretion to provide access under the FOIA unless the access is expressly authorized by other provisions of the Privacy Act.[473]

It is important to understand that the FOIA applies to a broader universe of information than the Privacy Act. The FOIA covers all "records." The Privacy Act covers only records in a "system of records." "System of records" is defined as "a group of any records under the control of any agency from which information is retrieved by the name of the individual or by some identifying number, symbol, or other identifying particular assigned to the individual."[474]

Exemption 6 covers "personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.[475] The U.S. Supreme Court held, in *Department of State v. Washington Post Co.*,[476] that "similar files" covers all information pertaining to a particular individual. Under this reading of "similar files," records involving all personal matters must be evaluated to determine if they meet two further criteria in Exemption 6.

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[472] Protection of proprietary commercial information is similar in many respects to protection of individual privacy interests.

[473] 5 U.S.C. § 552a(b).

[474] 5 U.S.C. §552a(a)(5).

Exemption 6 protects against only those disclosures that would invade a protectable privacy interest. Some information maintained on an individual involves no invasion of privacy, in which case access is permitted.

Even if a protectable privacy interest is established, however, a balancing test determines whether access would constitute a "clearly unwarranted invasion" of personal privacy. Specifically, the privacy interests which would be invaded by access to the record are balanced against the public's interest in access.

Even if some information in a record is protected by Exemption 6, the agency still must provide access to those "reasonably segregable" portions of a record that do not implicate privacy interests, redacting only those portions entitled to Exemption 6.

As §V(C)(2) explained, one of the security issues in electronic release of agency information involves redacting information protected by Exemption 6 from the electronic records before they are released. Many agencies avoid the electronic redaction issue by taking the position either that data in electronic form are not accessible under the Freedom of Information Act at all or that if electronic data are accessible, they need not be made available when programming or agency software is required to access the data.[477] This means not only that certain types of requests are denied, but also that if the electronic data contains exempt information or information protected by the Privacy Act, and programming or electronic access via agency software is necessary to redact it, the agency is not obligated to manipulate the data to extract only the disclosable portion.

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[475] 5 U.S.C. §552(b)(6).

[476]. 456 U.S. 595, 602 (1982). *See also* New York Times Co. v. NASA, 852 F.2d 602 (D.C.Cir. 1988) (tapes of astronauts' voices in Challenger disaster do not qualify as "similar file" under Exemption 6).

[477] But see §V(F)(4)(a)(iii).

vi. FOIA as a constraint on agency policies limiting retail dissemination

Certain interpretations of the FOIA are incompatible with an agency's limiting its role in release of electronic information only to a narrowly defined wholesaling function.[478] Suppose an agency establishes a policy that it will sell its raw data on magnetic tape but will not add value or provide on line disclosure. This essentially is the position that many existing vendors urge on agencies. Then suppose someone requests specific material from the electronic database under FOIA, taking the position that the agency is obligated to use its software and to do any necessary programming to retrieve the requested information.[479] If the FOIA requires the agency to accede, charging only the actual cost of the retrieval, the agency has effectively been forced to breach its policy only to wholesale and not to add value. This hypothetical more or less parallels the the facts in *Computaprint*[480] and *SDC Development*,[481] except that in *SDC Development* a restrictive interpretation of FOIA obligations was motivated to protect the agency's own market position rather than the role of private sector retailers. Of course, delays associated with information released under this hypothetical method might reduce significantly the value of the information thus released compared with on line dissemination or routine distribution of the information of magnetic diskettes or CDROMS.[482]

An even stronger potential for conflict between the FOIA and a wholesaling-only policy would arise if the FOIA were interpreted as requiring an agency to provide access to its retrieval software along with the raw data.[483] This would force the agency, in effect, to add value.

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[478] *See* §V(F)(2) regarding the distinctions between wholesaling and retailing.

[479] *See* Public Records Division, Office of the Massachusetts Secretary of State, Report of the First National Conference on Issues Concerning Computerized Public Records (1986)[hereinafter "State FOIA Report"], *supra* note 442,, at 6, 12, 13 (summarizing controversy over whether programs are disclosable under state FOIA statutes and whether agency must write a program to retrieve computerized information).

[480] The case is described in §III(F).

[481] *See* §V(F)(4)(a)(i).

[482] *See* §III(N) regarding pricing policy of USDA's EDI system.

vii. Electronic disclosure in agency regulatory proceedings

A few agencies[484] are contemplating or actually are exchanging information electronically with private parties to rulemaking or adjudicatory proceedings. Such initiatives contemplate providing dialup links to documents making up the docket for a particular regulatory proceeding and complete sets of documents on disk or tape. This type of electronic release[485] is desirable and furthers the purposes of the publication and public participation provisions of the APA by making party submissions and agency proposals available more quickly and permitting their contents to be organized, reviewed and synthesized by computer techniques. The electronic information thus exchanged for the most part is not information required to be published in the Federal Register, but only made available to those interested in the rulemaking proceeding.

Recommendation H encourages this kind of experimentation with electronic means of providing public participation in rulemaking and adjudication under sections 553, 554, 556 and 557 of the Administrative Procedure Act, when suitable provisions are made for those wishing to participate but lacking the means to access the electronic information.

The same cost-reducing and benefit-enhancing incentives that militate toward electronic exchange of docket information also militate toward electronic publication of certain information now published in the Federal Register. There is no legal reason in APA §553 or the Federal Register Act why the Federal Register cannot be published electronically as well as in its present paper form. Electronically published agency notices would be far more accessible to interested persons than a paper Federal Register, largely because of the potential for distribution via both dialup links and through depository libraries.[486] Electronic publication of Federal Register notices is unlikely to provoke controversy[487] until such time as the distribution or contents of a paper Federal Register is curtailed.

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[483] *See* §V(F)(4)(a)(iv)

[484] *See* §III(D) regarding FERC, §III(K) regarding NRC's LSS.

[485] Release is not feasible unless the documents are submitted by proceeding participants in electronic form.

[486] *See* §III(H).

The question is whether certain agency notices ultimately might be published in electronic form only. Under present statutory language, the proviso in §552 (a) (1) that exempts from the Federal Register publication requirement information otherwise widely disseminated, subject to the approval of the Office of Federal Register, would seem worth considering. By the end of the century, a paper Federal Register may well be replaced by an electronic equivalent, though it is reasonable to expect Congress to amend the statute when this becomes feasible and acceptable.

b. Pricing—user fees

Information pricing issues are inseparable from questions regarding measurement of costs and benefits,[488] economic characteristics of electronic information,[489] FOIA obligations,[490] and the respective roles of the public and private sectors. The pricing of electronic information involves cost, competitive effect and public availability issues. Even if government information in electronic form is superior to the same information in paper form, a high price for electronic access makes the information practically unavailable to some segment of the public.[491] The same result obtains if the information is available free or at very low costs only at agency headquarters or only a few locations, while prices are high for dialup electronic dissemination of the information. So low government prices for value-added electronic information offer benefits to information consumers, at least in the short run. Low government prices for bulk electronic information can stimulate further competition in private markets, resulting in lower private prices.

Pricing by private sector providers may enhance or impede public availability of government information.[492] If high private prices impede desirable levels of availability, a government policy that restricts agencies from competing with private sector vendors erects a barrier between citizens and their own information. On the other hand, if all government information were disseminated free, the cost would be enormous, and it is not clear how such disclosure would be financed, considering competing demands on public resources.

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[487] Except regarding competition with private vendors.

[488] *See* §V(D).

[489] *See* §V(F)(1).

[490] *See* §V(F)(4)(a)

[491] *See* 50 FED.REG. at 52748 (App. IV to OMB Circular A-130) (recognizing that cost-based user fees for electronic dissemination might, in some instances, unduly impede public access).

It is not entirely clear that reliance on tax dollars to fund new forms of information dissemination is appropriate in an era of budget constraints. Nor is it sound policy to keep the government entirely out of electronic release activities. So, an inevitable question must be answered when the government releases information electronically: how much should it charge for it? There is nothing intuitively wrong with user fees to permit a more sophisticated information dissemination program paid for by those who receive the benefits.

The FOIA constrains fee policies for electronic information made available under the FOIA.[493] This section primarily focuses on how the law constrains pricing choices agencies may make for electronic disclosure in public reference rooms and electronic dissemination via dialup links or sale of tapes and disks.

The User Fee Statute[494] and a 1959 OMB circular set general guidelines for establishing user fees for government services.[495] These guidelines say that services or things of value provided by an agency to a person should be self-sustaining through user charges. The statute requires the charges be "fair" and based on four factors: costs to the government, the value of the service or thing to the recipient, public policy or interest served, and other relevant facts.[496]

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[492] Most of the general public lacks the technology to use information in electronic form; only a tiny fraction of the population has microcomputers and modems. But certain publics, who frequently are the intended consumers of specific agency information, do have technological capability. Lawyers in general, and intellectual property lawyers in particular, are examples. Other publics, like libraries, serve as conduits through which information flows to the general public. Libraries generally have the technology necessary to use information in electronic form. *See* §III(H).

[493] *See* V(F)(4)(a) (introduction).

[494] 31 U.S.C. §9701 (1982).

[495] *See* 50 FED.REG. at 52748 (App. IV to OMB Circular A-130) (reiterating 1959 guidance and discussing factors relevant to user fees for electronic dissemination).

These legal criteria embody conflicting considerations, and provide ample authority for agencies to price electronic information in accord with policy judgments.[497] The self-sustaining criterion suggests that the government should price information products at a level sufficient to cover fully and fairly allocated capital costs, and the OMB circular suggests that users should pay their fair share of the full cost to the government.[498] Following this criterion to its limits, however, could result in high prices, based on part of the capital costs of hardware and software necessary for internal agency storage, management and retrieval of information. Such prices would reduce competition with, and enlarge the role of, the private sector. The government's capital costs are likely to be higher than the private sector's because of complex procurement procedures and the cost of providing internal agency data management and retrieval capability which need not be part of a private sector information product. On the other hand, such prices would provide few direct benefits to information consumers.

The value criterion suggests that government information should be priced according to the value to the recipient. The House Policy document[499] suggests that pricing of information on the basis of value rather than costs is practically unsupportable in the absence of authority for the government to copyright information. FOIA obligations tend to undercut a value-based or a full-capital-recovery pricing policy.[500]

The cost-to-the-government criterion could be interpreted to require that information be priced at marginal costs—exclusive of costs for that portion of an information system that provides utility to the government itself. Public policy for some types of information also might militate in favor of free or below cost pricing. But following this criterion to its limits would result in much greater competition with the private sector when public funds pay capital costs for the hardware and software, producing value-added electronic information products as a byproducts of internal agency automation.

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[496] 31 U.S.C. §9701(b).

[497] *See* §V(F)(3).

[498] Circular A-130, App. II, para 4(c), 50 FED.REG. at 52741-42; see also House Policy Report, *supra* note 124, at 37.

[499] House Policy Report, *supra* note 124, at 37. *See* §V(B)(8).

[500] *See* §V(F)(4)(a)(vi).

As Section V(F)(2) explains, low government prices for value-added electronic information products can discourage desirable private sector activity. But not all private sector interests want high prices for all government electronic information products. There are conflicts within the information community. For example, for a time, the information industry urged the Congress to require the National Library of Medicine to increase its prices for certain information, arguing that the private sector could not compete at the prices being charged. Eventually, however, congressional staff persuaded the industry that value-added resellers of electronic information would be disadvantaged by government price increases for data since the prime source of raw information is the government.

As a general matter, the private electronic information industry can be expected to urge interpretations of user fee statutes that result in high prices for value-added information offered at retail. Present vendors also may urge interpretations that result in high prices for bulk information offered at wholesale, in order to limit competition with their established information products. New potential vendors are likely to urge interpretations that result in low prices for bulk information because it will make it easier for them to get into the market.

Assuming that wide public availability continues to be a policy goal, that the cost of such availability with present technology exceeds the ability of some members of the public to pay, that insufficient resources are available to make the full universe of government electronic information available free, and that diversity of electronic information products and vigorous private markets also continue to be policy goals, some tradeoffs are appropriate.

These tradeoffs should be made based on costs and benefits of different approaches. One can, of course, conclude the cost/benefit analysis differently based entirely on the probable economic demand for information instead of on legal obligations. To a considerable extent, a strong economic demand for information reduces the need for aggressive agency electronic publishing initiatives, or at least makes it more likely that the private sector will retail the information effectively if the agency restricts itself to a wholesaling role. But as the commentary to Circular A-130 says, ability to pay is not necessarily an appropriate criterion for receiving certain types of government information.[501]

As Recommendation C suggests, the nature of electronic release initiatives and the pricing of electronic information products by federal agencies should depend on the content of the information,[502] and its value in promoting meaningful public involvement in the functions of government or in complying with law.

Agencies should act to make widely available information, priced at a level that any citizen can afford, such as that contained in the Congressional Record, which is constitutionally mandated to be available to a wide segment of the citizenry, or such as that contained in the Federal Register, which is statutorily mandated to be made available, even if the mandate puts the government in the retail publishing and distribution business at prices that do not cover costs fully. Other information which should be widely available includes the text of statutes, regulations and judicial opinions. Arguably patent information, the distribution of which is contemplated by the Constitution to be useful to promote technological innovation, similarly should be distributed widely. Data defined in §313 of the Emergency Response and Community Right to Know Act is another clear example, because a statute requires EPA to make this information available in electronic form.[503] Wide availability implies electronic dissemination, but it does not necessarily imply an electronic retailing function by government agencies. Dissemination through depository libraries and through private sector value-added resellers may offer greater benefits and lower long-run costs than direct electronic subscriptions.[504]

Other information exists to which public disclosure is desirable, warranting government involvement to make it available, but where the users should pay the full cost of making it available. This classification probably includes SEC information and most tariff information.

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[501] Circular A-130, App. IV, discussing paragraph 11(a), 50 FED.REG. at 52748.

[502] House Policy Report, *supra* note 124, at 9 (general public availability of information is a principal goal of governmental information policy, however, information should not be made available if there is legitimate governmental or private interest opposing disclosure).

[503] *See* §III(V);.

[504] See the example of federal court of appeals opinions in V(F)(2).

A residual category involves information of a type, or in a form, that the government should not be providing directly at all. Examples would be legal treatises, with substantial analytical value added to raw statutory, regulatory, or judicial decision material, or literary material. Thus a significant government role might be appropriate in disseminating summaries of OSHA standards, regardless of demand. Conversely, even though the demand might be high, it would not be appropriate for the government to publish an electronic edition of Hemingway's Old Man and the Sea.

Recommendations C and D suggest that agencies should evaluate possible new electronic information products in a three step process, working from a baseline of traditional paper information products and evaluating costs and benefits of electronic information products with essentially the same content. The first step in the evaluation process is identifying the form in which information that would be contained in a new electronic information product currently is released: (1) released only in response to FOIA requests (access); (2) released through a public reference room or some similar means that facilitates public availability (disclosure); or (3) published and distributed by the government or by the private sector (dissemination).

The second step is to identify the benefits and costs of replacing or supplementing existing means of release with different levels of electronic release, specifically including: (1) release of electronic information only in bulk or only in response to FOIA requests; (2) release of electronic information only through public terminals in public reference rooms; or (3) electronic publishing, involving on-line, dialup links or sale and distribution of magnetic or optical disks formatted so as to permit easy retrieval on a small computer. An electronic information product should not be proposed by an agency unless the cost/benefit analysis demonstrates that the electronic alternative analyzed is superior to existing means.

In some cases of course, a new electronic information product involving publishing is warranted despite the absence of a comparable paper product. One clear example is the electronic database of hazardous materials explicitly mandated by the Superfund Amendments. In other cases there is no statutory mandate but the benefits of a new product are appreciable and the costs are so much lower than for a paper equivalent that a new product is warranted. An example is the Federal Energy Regulatory Commission's electronic bulletin board of commission documents.

The third step, addressed by Recommendation D, is defining the appropriate roles of the public and private sectors in providing electronic information products (including telecommunications facilities, indices and retrieval software as well as raw data) justified under step two, based on the relative costs and benefits of privately versus publicly provided information products. This is where pricing enters the policy equation.

Agencies should identify electronic information products available from private sector sources, and consider explicitly the relationship between those products and natural byproducts of agency automation activities. Electronic information products identified and evaluated favorably under step two should be evaluated further to decide whether the public or the private sector should "manufacture" and "distribute" the product. This decision requires identifying costs and benefits associated with public sector "manufacturing" and delivery of the product compared with the costs and benefits associated with private sector "manufacturing" and delivery of the product. In this context, both "manufacturing" and "distribution" involve adding value. Manufacturing involves reformatting and structuring data and developing software to facilitate retrieval and ultimate use.

In this part of the cost/benefit evaluation of public and private sector roles, agencies should consider how existing or projected private-sector prices compare with agency estimates of information product costs.

Costs higher than private sector prices indicate the existence of private sector efficiencies or cross subsidies that cannot, or should not in most case, be matched by the government. Competing government information products at higher cost-based prices either will not be used or will result in higher costs to information consumers for products providing the same benefits as lower-priced private products. The government should not compete with respect to such products. Exceptions to this rule of thumb must be justified by the peculiar nature of the information and special needs for its wide dissemination.

Wide availability of some information is so desirable, as discussed earlier in this section, and electronic publishing of some types of information may offer such benefits in increasing public availability, that below-cost pricing is warranted. There are various ways of pricing at less than full cost. The government could publish and distribute itself, paying the cost from public funds. The government could contract with a private sector enterprise and pay, out of public funds, a fee for services. The government could subsidize private firms out of public funds. The government artificially could protect certain markets for electronic information so as to generate sufficient monopoly profits in those markets to provide an internal cross subsidy for electronic publishing and distribution activities by the same firms in low-price markets.

Costs significantly lower than private sector prices indicate either oligopolistic or monopolistic pricing by the private sector, or government efficiencies resulting from capital investment in internal processing systems. In either event, such a disparity between costs and prices suggests favorable cost/benefit effects from agency disclosure or dissemination. The nature of agency action should depend on the content of the information.

If the information is such that wide public availability is desirable at low costs, direct government retail dissemination at below-market, though cost-based, prices is appropriate. The same policy justification for public subsidy also justifies giving the public the benefits of low government marginal costs.

In other cases, the content of the information suggests that public disclosure is desirable, and pricing decisions must be based on whether losses in product diversity and the possibility that the government may not be able to sustain its disclosure activities in the long run outweigh public benefits resulting from lower cost-based government prices. The content of the information suggests that users should pay full costs for the information, but government investment offers the potential of lower full costs. "Full cost" in this context should not include capital costs of computer systems developed for agency purposes, only capital and operating costs for that portion of the system designed for public disclosure. Of course the cost allocation decisions may be controversial.

In the cost, benefit, and information-content configurations explored in the preceding paragraphs, no artificial restriction on government electronic release activities is necessary or appropriate.

Nevertheless, choices still can be made regarding public and private sector roles. Retailing and wholesaling electronic information release are not mutually exclusive: the government might retail to some degree but also wholesale to private sector information resellers who would create retail information products different from those offered by the government. This is expressly contemplated by Recommendation C(2). For example, agencies might engage in electronic publishing, providing direct "retail" public dissemination, while still preserving opportunities for private enhancements such as "one stop shopping" for wider categories of information or improved search and retrieval techniques. Higher private sector prices would satisfy a demand for products with more value added.

One other configuration, however, does justify artificially restricting government electronic release. The government can be essentially indifferent as to how widely certain information is distributed, beyond satisfying legal obligations under FOIA. If cost-based government prices for electronic access or disclosure for this type of information are higher than private sector prices, the decision is easy: do not offer the uncompetitive, higher priced, government information product. But if cost-based government prices for disclosure or dissemination would be lower than private sector prices, the decision is harder. The content of the information means that the public benefits from direct government disclosure or dissemination do not justify higher levels of electronic release. The government simply should make the information available at "wholesale" in a form that will enable private sector resellers to add value and distribute the information, to the extent that consumers are willing to pay the price necessary to attract private capital.[505]

c. Implementing electronic release and pricing policies by contract

Several sections of this report and recommendations C & D urge agencies to consider the role of the private sector in disseminating electronic information. The preceding section suggested that an agency might implement its electronic publishing policy by contracting with a private electronic information reseller to provide desired levels of availability at appropriate prices, while limiting the agency's competition with the reseller.

Ensuring the availability of a private sector information product in conjunction with a government decision to limit government information product offerings is difficult legally. Conceptually, the government could contract with a private sector information provider, obligating the private sector provider to make the product covered by the contract available for a particular term. In exchange, the government could commit itself not to compete with the private sector product. The government promise would be not to add value. The government still would be free—and would be obligated to—provide access to information in bulk, in other words, to wholesale information to any potential competitor.

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[505] *See* §V(F)(2) regarding retailing and wholesaling.

The difficulty is not that the government would be unable to enforce the private provider's part of the bargain (it could), but that the private sector provider could not enforce the government's part of the bargain. The contract could be enforced to preclude the government from directly offering a competing product, but it could not be enforced to prevent a private competitor from using government information in electronic form to compete with the private contractor. For example, suppose an entrepreneur files an FOIA request with the contracting agency for data in electronic form and for retrieval and telecommunications software developed for internal agency use. Under the most likely interpretations of the FOIA, the government would be obligated to make the requested electronic information available.[506]

The new competitor, therefore, could begin competing with the private contractor, presumably with much lower startup costs, because it has the benefit of agency-created data and software. No apparent legal theory based on the contract would permit the contractor to prevent public access to the information covered by the FOIA request.[507]

Obviously, if the indexing, retrieval, and telecommunications software were proprietary and not owned by the government, its release could be blocked, but not otherwise. So, the efficacy of the contract approach to insure continued availability of a particular information product would depend on (1) appreciable value added by the private contractor representing an economic barrier to entry by competitors and (2) the unavailability of comparable added value in government-owned software disclosable under the FOIA.

On the other hand, if contract obligates the private contractor to reduce prices in exchange for the protected market, incentives for new private sector competition would be reduced.

Also, if the deal involves first-time conversion of paper information, and the government has no need for internal use of the information in electronic form,[508] the deal could be structured so that the private contractor converts paper information into electronic form. In this case, the electronic data arguably would not belong to the government but to the private contractor, and therefore could be protected from access under the FOIA. The viability of this legal theory is at the heart of the controversy between Computaprint and USPTO.[509]

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[506] *See* §V(F)(4)(a)(iv).

[507] *See Computaprint*, discussed in §III(F).

[508] But this assumption is at war with reality. If the agency has no need for the information in electronic form, it has no business manipulating private markets for electronic forms of the information.

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[509] *See* §III(F) for a description of this case and its status.

VI. TECHNOLOGY ISSUES

The most difficult issues arising from electronic acquisition and release programs are policy and legal issues; the technology is available now to do most of what agencies and their constituencies want. But there are some specific technology issues that deserve consideration.

A. Compatibility

Electronic acquisition and release are intended to facilitate communication. They cannot do this unless the computers at each end speak the same language.

1 *Sources of Incompatibility*

Whenever electronic information is to be exchanged, compatibility issues arise. The most serious compatibility issues relate to file compatibility rather than hardware compatibility. Different and incompatible computer systems can communicate with each other through a variety of well-accepted telecommunications standards.[510] The problem is making sense of the information once it is received. A word processing document created with Word Perfect software does not make sense to Displaywrite software, and a Microsoft Word or Xywrite document makes no sense to Word Perfect. A database file created with dBase III+ cannot be used directly by Rbase V. A spreadsheet created in Lotus 123 cannot be used directly by Excel. A file formatted according to FMC EDI specifications cannot be used by the IRS system, even if the file contains tax information.[511]

File incompatibility arises because of the need to preserve structural or formatting information, as well as textual or numerical information, in a file. Spreadsheets and database files are more complex structurally than word processing document files. So it is easier to explain the source of the file compatibility problem in connection with wordprocessing files.

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[510] *See* §II(B)(2).

[511] It is quite unlikely that an FMC tariff would contain tax information; the point of the example is that formats designed around one agency's needs are unlikely to fit another agency's needs.

A word processing document in electronic form is much more than just a computer-generated file of text characters. In addition to the text itself, a word processing document also must have codes that tell the computer when to underline, when to print material in bold face or italic styles,[512] when to make a paragraph break, when a line ends, where to set the margins and where to begin and end footnotes. Such formatting information is required when the computer prints a file on paper, and it also is required to present a WYSIWYG[513] display on the screen.

No two word processing software products perform the formatting function the same way. Some products use an ASCII[514] representation as the baseline, identifying format codes by surrounding them with special characters such as "@" or "<". Others present formatting information on a line by itself, preceded by a period in column one.[515] Other products encode both text and formatting information in a non-ASCII representation. Some embed footnotes adjacent to text references; some save footnotes on separate pages, or even in separate files.

The variety with which word processing products express formatting information is the major reason why files created by different word processing packages are incompatible with each other.

Database and spreadsheet file structures are even more complex and diverse. Both types of files have a structure so that the computer and the user know what information signifies what.[516] There are many different ways to define the structure, associated with designers' efforts to improve computer efficiency, preserve flexibility to modify the structure, and to afford a friendly user interface.[517]

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[512] Such codes are called *graphic attributes.*

[513] WYSIWYG (pronounced wisi-wig) is an acronym for What You See Is What You Get, meaning that the video display corresponds as closely as possible to the appearance of the same material on a printed page.

[514] ASCII codes are a means of representing alphabetic characters numerically.

[515] Wordstar is the most pervasive example. A period in column one is a good way to indicate format information because a period would never appear in the first column of ordinary text.

[516] *See* §II(B)(3).

[517] *See id.,* regarding database structure, coding and tagging.

2 *Possible Solutions*

a. EDI

Solutions to format incompatibility differ according to whether users want electronic information in structured, free-text, or image form.

Structured data is the hardest non-image data type to deal with. One possible solution to standardizing the format of electronic agency information is ANSI standard X.12, the Electronic business Data Interchange ("EDI") format, developed originally to standardize the format for commercial information such as invoices and bills between suppliers and their customers. Electronic Data Interchange ("EDI") is a family of standards for the electronic exchange of commercial information

Major corporations use EDI to reduce the costs of dealing with their suppliers and commercial customers. Major users include GE Information Service, Ford Motor Company, General Motors Corporation, General Mills, Inc., General Foods Corporation, 3M Company, K-Mart Corporation, Procter & Gamble, JC Penney Company, Sears Roebuck & Company, Consolidated Rail Corporation, and Bethlehem Steel Corporation.[518] Some EDI based databases are available on industry specific networks, in the pharmaceutical and grocery retailing industries. These databases provide subscribers with sales, market share, and demographics information.[519] Some Public Data Networks provide EDI formatting capability.[520]

Some observers believe that EDI is too broad to provide for extensive cross industry communication without more development.[521] While EDI has ANSI standard X.12 as a common base, many variants exist. Typically, an industry or major corporation selects an EDI specialist to design electronic forms that will be suitable for the particular industry and then to standardize the transmission method, transmission rate, and hardware. Typically, an industry settles on a particular third party network, such as GE Information Services, Western Union, or Information Network.

EDI has not been considered seriously as a solution to the electronic data tagging issue by many of the programs discussed in this report, except for the FMC program, and for part of the Customs program, which has endorsed the international EDI standard, "EDIFACT," as a format for filings. The flexibility of the EDI process made it relatively easy for persons concerned with FMC tariff information to develop EDI standards meeting their needs already in use commercially by members of the industry.[522]

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[518] COMPUTERWORLD, January 6, 1988, at 40.

[519] *Id.*

[520] Western Union's Easylink is an example.

[521] *See* COMPUTERWORLD, January 6, 1988, at 42.

There is no reason to force a particular standard on agencies. IRS and Customs format compatibility has been ensured with little controversy through ASCII field specifications. Nevertheless, as EDI standards become more common, an agency starting a new electronic acquisition or release program should consider if a significant portion of its information filer or consumer communities already uses an EDI standard before defining a new standard from scratch.[523]

b. Text file format conversion

Text file format compatibility is easier to ensure than structured file format compatibility. Textual format compatibility usually is simply a matter of converting format codes, although a certain amount of database-like structure must be superimposed on the text for headers and acknowledgements to achieve filer identification, signature and security objectives.

Some of the difficulty of inserting typesetting codes or converting wordprocessing software formatting codes can be resolved by using sophisticated and popular word processors like Word Perfect, Xywrite or Microsoft Word or sophisticated and popular desktop publishing product like Ventura. Such products have some format conversion capabilities. Some also accommodate "style sheets," which permit similar levels of text or display elements to be reformatted throughout a document in one operation.

Reasonably priced commercial products exist to convert word processing files.

c. Database retrieval standards

It is desirable to adopt standards for retrieving structured database information. Release of agency electronic information in a form usable by commercial software facilitates use of the information, enhancing the purpose of releasing it. It also reduces the likelihood of FOIA requests for retrieval software or agency retrieval programming.[524]

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[522] *See* §III(E).

[523] *See* Recommendation J.

Two standards for retrieving information from electronic databases are emerging, which have implications for agency release programs, because commercial software developers are adopting them. They are SQL (Structured Query Language) and QBE (Query by Example). SQL is a programming language that facilitates flexible retrieval of information from relational databases in ways not easily anticipated when the database is designed. QBE is a mode of presenting database information on a computer screen so that an unsophisticated user can specify the information to be retrieved simply by giving examples in a grid on the screen.

3 *Page Images*

Page images[525] superficially avoid format compatibility issues because they are just pictures of printed pages. But this superficial impression is misleading. If page images are to be transferred electronically, the sending and receiving computers must know what part of an image is represented by each bit in a linear stream of bits.[526] Moreover, adequate resolution of detail requires very large amount of information. The USPTO,[527] IRS,[528] and Nuclear Regulatory Commission[529] must confront these issues in order to construct useful systems. CCITT Group 4 standards are an appropriate starting point, as USPTO has decided. Advances in communications links and in data compression are necessary before on-line access to page image data can become a reality for many information consumers.[530]

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[524] *See* §V(F)(4)(a)(iii), (iv).

[525] *See* §II(B)(3) for an explanation of page images, as compared with character representations.

[526] Or, in object oriented page images, what the shape, size, orientation, and position codes mean.

[527] *See* §III(F).

[528] *See* §III(B).

[529] *See* §III(K).

[530] It would take too long transmit the information required at present data communication speeds.

B. Setting Standards and Making Technical Information Available

The National Institute of Standards and Technology ("NIST")[531] has authority to develop uniform standards and guidelines for Federal computer systems.[532] NIST submits these standards and guidelines along with recommendations as to their binding effect to the Secretary of Commerce[533], who on the basis of the NIST submission, sets minimum requirements for federal agency computer systems.[534] The Administrator of General Services must revise Federal information resources management regulations to be consistent with the Secretary's standards and guidelines.[535]

Paragraph 9(c)(1) of OMB Circular A-130,[536] authorizes the Secretary of Commerce (presumably acting through the National Institute of Standards and Technology) to issue information processing standards and guidelines to ensure effective acquisition, management, security and use, and to provide scientific and technical advice.

The National Institute of Standards and Technology is embarked on a major effort to develop "FIPS PUB" standards (including those for optical disk technology) for use by government agencies in electronic systems.[537] The Government Open Systems Interconnection Profile ("GOSIP"), version 1.0, was published in the Federal Register for comment in 1987.[538]

C. Difficulty of Providing Access Without Retailing

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[531] Formerly the National Bureau of Standards.

[532] .15 U.S.C.A. §§ 278g-3(a)(1)-(a)(3) (excluding those systems in 10 U.S.C.A. § 2315 and 44 U.S.C.A. § 3502(2)).

[533] .15 U.S.C.A. § 278g-3(a)(4)

[534] . 40 U.S.C.A. §§ 759(d)(1)-(d)(2) (West Supp. 1988).

[535] . 40 U.S.C.A. § 759(d)(4).

[536] 50 FED.REG. 52730, 52737 (Dec. 24, 1985).

[537] *See* FIRMR, 41 C.F.R. Subpart 201-8.1, especially §201-8.102-1.

[538] 52 FED.REG. 41488 (Oct. 28, 1987).

If agencies are obligated to provide public access to computerized information, one attractive way of doing so is to provide public-use retrieval terminals or to provide telephone lines for remote retrieval through microcomputers.[539] If agencies provide such terminals or remote microcomputer access, database software necessarily must be available to permit database queries to be formulated by persons lacking substantial computer programming expertise. Such software is within almost any definition of "added value," and making it available thrusts agencies into an information retailing role to some extent.[540]

It is difficult therefore, to draw a clear line between retailing and wholesaling of information without artificially restricting access to computerized information. This essentially is the position taken by FMC regarding public access to tariff data.[541]

One could, however, as suggested in the commentary to Recommendation D, distinguish between that part of retailing that results from adding value in the form of search and retrieval software and indices, and that part of retailing that results from providing telecommunications disclosure. Such a distinction would permit a principled distinction to be drawn between easy-to-use electronic disclosure in an agency reading room, and nationwide dialup links. There is room for argument whether the dialup links contemplated by the FMC represent value-added "dissemination" because of the dialup capability, or whether they represent cost/effective "access" or "disclosure" without added value beyond byproducts of the internal automation.

D. Use of Artificial Intelligence Techniques

Artificial intelligence techniques of the rule-based expert system variety offer potential benefits for agency analysis of electronically acquired information. The Customs Service, IRS, SEC and DOT understand the potential in connection with initial screening of filings, application of criteria to focus inspections or enforcement scrutiny, and to generate form documentation. Most existing systems embody a complex set of rules for such purposes, though usually not written in a computer language associated with Artificial Intelligence.

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[539] *See* State FOIA Report, *supra* note 442, at 8, 15 (summarizing pros and cons of public disclosure terminals).

[540] *See* §V(F)(2).

[541] *See* §III(E).

The IRS prototype expert system for reviewing pension plans[542] is worthy of imitation.[543]

The point is not that AI is necessary to permit retrieval and action-oriented computer decisions about electronic data. Rather, AI research has produced useful insight into expressing legal or administrative rules in computer programs. Those insights are worth broader trials in agency electronic information systems.

E. Public Data Carrier Use

Public Data Networks[544] offer a number of advantages for agency acquisition and release programs: subscriber mailboxes, error checking protocols, communications security features, and aggregation of communications channels. Few agencies have given these advantages enough attention, although these advantages of public data networks motivated the Securities and Exchange Commission to require bidders for the operational phase of the EDGAR system to consider use of public data networks rather than multiple low speed telephone lines as were used predominantly in the pilot phase of EDGAR.[545]

Use of Public Data Networks can relieve agencies of the cost and management burdens of operating large numbers of dialup telephone links themselves.[546]

F. Storage

Most of the databases considered in this report can be handled by conventional mainframe computer and magnetic disk storage technologies. The USPTO and IRS databases are exceptions, because of their enormous eventual size. Accordingly USPTO and IRS must force storage technology to some degree. Optical disk technology offers important advantages over magnetic disk storage, chief of which is higher density. A 500 megabyte capacity optical disk is much smaller than a 500 megabyte capacity magnetic disk. Because their storage requirements are greater than those of other agencies considered in this report, USPTO and IRS have worked to advance optical disk technology. USPTO has explored means of accessing information stored on large numbers of optical disks.

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[542] *See* §III(B)(2).

[543] Grady and Patil, *An Expert System for Screening Employee Pension Plans for the Internal Revenue Service*, Proceedings of The First International Conference on Artificial Intelligence and Law 137 (1987) (The Association for Computing Machinery Ord. No. 604870).

[544] *See* §II(B)(2) for a description.

[545] EDGAR RFP at C-28.

[546] Though not necessarily the billing for user access to a PDN. Most PDN contracts obligate the large-volume subscriber to pay for all access to the subscriber's database.

The principal problem with large optical disk databases is the higher probability of multiple users wishing to access information stored on a disk not immediately available to the system.

Two technologies are promising: a "jukebox" approach, which utilizes a device that mechanically selects the appropriate disk and places it under a read head, and a "rapid access" technology, which is similar to current magnetic disk pack technology, in that all disks are under read heads all the time. Access time for jukebox technology to find a patent file and present it on an examiner's screen is less than 7 seconds for jukebox technology and less than 1 second for the rapid access technology. The rapid access technology is much more expensive than the jukebox technology. USPTO will begin attaching jukebox drives to its network beginning in June, 1988 to evaluate the drives in a production environment. USPTO also is working closely with the Social Security Administration, the Department of Defense, and the National Institute of Standards and Technology to develop common federal government approaches to storing large quantities of information.

G. Transfer Technologies

Both electronic acquisition and release involve one or more electronic transfer technologies. Alternative technologies for releasing information are especially important to consider. On-line disclosure[547] is not the best way to distribute large quantities of information, given speed limitations of ordinary telephone connections. For consumers such as depository libraries who need the entire contents of the Federal

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[547] On-line access involves the information consumer establishing a communications link with the agency.

Register and the Congressional Record, or access to image data from the USPTO database, distribution via CDROM media, or conceivably by satellite microwave links may be appropriate. CDROM distribution would preserve some of the same physical distribution costs that presently exist with paper systems, resulting in delayed availability of information. A satellite link would eliminate the delay requirements but would require that users have appropriate satellite antennas, receivers, and computer capability to accept the information as it is broadcast.

Ultimately, government information of a time sensitive nature like the Federal Register and the Congressional record, intended for wide audiences, should be broadcast over a satellite link that could be received by anyone with an appropriate satellite antenna. This mode of dissemination would make the information available to a nearly unlimited variety of resellers and ultimate consumers at distribution costs to the government that would much lower than paper distribution, publication of magnetic or optical digital media, or dialup links.

VII. RECOMMENDATIONS

Information long has been recognized as playing an essential role in a democratic political system. The rapidly advancing revolution in information technology raises anew many economic and policy issues addressed by agencies, Congress and the courts with respect to information in general. The technology makes it possible for agencies to acquire information electronically and also makes it possible for agencies to release information electronically. Electronic acquisition can occur by submission of magnetic tape, cassettes, disks, optical disks, or transmission over telephone links. Information can be released electronically via the same media, and by satellite transmission.

The new information technologies can improve public access to public information, and reduce paperwork burdens, but they also can impose significant economic burdens and threaten the position of established electronic information enterprises.

The following recommendations are intended to guide agencies that keep and use information in electronic form, when electronic acquisition and/or release of the information from or to the public is necessary to the agency's mission, or is required by the Freedom of Information Act ("FOIA").

These recommendations do not reflect value judgments different from those underlying OMB Circular A-130. They do, however, elaborate on cost and benefit categories to be considered in deciding to release information at three different levels and to be considered in allocating responsibility between public and private sectors. The recommendations distinguish specific types of dissemination activities that may be performed better or more cheaply by agencies or private enterprise. The recommendations also provide more detail on FOIA obligations as applied to electronic information.

The policy and legal issues differ somewhat depending on whether one considers electronic acquisition by agencies or electronic release by agencies. The policy and legal issues pertaining to electronic release differ considerably depending on whether one considers access obligations under the FOIA in response to discrete requests, or whether one considers more active agency initiatives to disseminate information through some form of electronic publishing. The recommendations begin with the FOIA because that statute is broadly applicable to all agencies, with important implications for how agency-specific electronic release initiatives should be conducted.

Many of the recommendations necessarily beg the question as to where lines should be drawn and who decides whether abstract criteria are met in particular cases. In this stage in the evolution of government electronic information policy, the most one can do is to suggest substantive principles to be applied in the first instance by agency electronic system designers, policy makers, and budget planners. The objective is to provide an analytical framework within which agencies can think about options, and justify choices made, by articulating their rationale according to the framework. Ultimately, of course, responsibility for policing compliance with the framework or for deciding whether the framework is appropriate rests with the courts interpreting existing statutory authority and obligations, and with the Congress in reshaping agency duties. As experience is gained, the Congress ought to set policy on as broad a basis as possible. It ought not to specify the details of particular acquisition or release programs.

As with any important societal change, the revolution in information technology occurs at a different pace in different sectors of the society. It is inevitable that some private filers of information with the government will sometimes have technology that exceeds the government's ability to accept the information in the form in which it is kept and most easily filed. In other cases, the reverse will be true. In many cases, the government will be ready to provide, and will prefer to provide for economic reasons, information in electronic form to persons who are not ready to consume it in electronic form. It will be a long time before every citizen has a microcomputer and a modem. Until such time as most citizens and government agencies have roughly equivalent technologies, transitional arrangements will be necessary to ensure that electronic acquisition and release do not prejudice major segments of the population.[548]

These recommendations do not address some important issues in detail, such as specific techniques or legal theories to protect trade secrets or privileged commercial information, to prevent access to information that would invade personal privacy, or otherwise to enhance security of electronic databases. These subjects deserve separate investigation.

A. Freedom of Information Act

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[548] House Policy Report at 10 (Finding A(5): public access is dynamic concept).

1. Agencies should interpret the Freedom of Information Act to cover electronic information.

2. Agencies should not frustrate the purposes of the FOIA by replacing systems of paper records with electronic databases, and then denying access to the electronic data on the grounds that the electronic form of pre-existing paper records data is not a "record," that retrieval of the electronic information is equivalent to creation of a "new" record, or that programming is required for retrieval. On the other hand, agencies should not be obligated under the FOIA to create large new databases for economic exploitation, in effect paying capital costs for private ventures.

3. Differences in agency technologies and database structures make it necessary, for the near term, to define FOIA obligations on a case-by-case basis. Specific controversies under the Act, over how requesters must define records, how much programming an agency must do, if any, and how costs shall be borne, cannot be resolved soundly until agencies and requesters gain further experience with electronic information. The concepts of reasonableness applied to FOIA requests and searches for paper information is a useful guideline for resolving electronic FOIA controversies.

The report considers FOIA issues in §V(F)(4)(a).

A change in the form in which information is kept, indexed, and retrieved should not erode the spirit of the FOIA by increasing the frequency with which agencies decline access altogether, by forcing requesters to take data in gross in forms usable only by the technologically sophisticated, or by forcing requesters to obtain information from private sector providers instead of from agencies directly. Nothing in these recommendations or the supporting report should be understood to suggest that resolution of electronic publishing issues should relegate FOIA requesters to private sector information providers or otherwise restrict or make more expensive access to which they are entitled under the FOIA.

In many respects, the FOIA issues and the "electronic publishing" issues addressed in Recommendations D to F are independent. The FOIA involves a statutory access mandate and gives rise to controversies over interpretation of statutory terms and legal rights and obligations. Electronic publishing involves a broader array of policy and economic judgments involving the best way to provide information products in a market economy, while also occasionally raising issues about the scope of an agency's mandate and authority.

Nevertheless, there are inter-relationships between the two subjects. It is conceivable that agencies might be so zealous in restricting themselves to wholesaling of electronic information in order to serve policy judgments about the role of the private sector (see Recommendation E) that they would impede FOIA access.

Conversely, certain interpretations of the FOIA are incompatible with an agency's limiting its role in release of electronic information only to a wholesaling function. If the FOIA requires an agency to afford direct computerized access to computer databases, charging only the actual, marginal, cost of the retrieval, the agency effectively has been forced into a retailing role, because it must make available indexing and retrieval software in order to provide the requested access.

The introductory preamble noted that the Congress ought to set electronic information policy on a broad basis. The FOIA is a good example of a broad policy vehicle because it is a government wide information statute. As more experience is gained, it may be appropriate for the Congress to consider matters such as how "programming" costs should be borne, and whether retrieval software is a "record" disclosable under the act.

B. Acquisition of Information in Electronic Form

1. Agencies should acquire information in electronic form when agencies use the information in electronic form and when most information submitters already maintain information electronically, or have ready access to intermediaries who will prepare and submit it in electronic form. When agencies sponsor electronic acquisition programs, they should ensure that all information of the same type eventually is available to them in electronic form, either by strictly administering exceptions to mandatory programs, or by undertaking the conversion of paper submissions into electronic form themselves.

2. Agencies incur significant costs when they acquire information in paper form and convert it into electronic form. Private sector entities providing information to the government also incur costs when they

must convert electronic information kept in electronic form into paper form for submission to the to the government. It is therefore desirable in many cases for the government to acquire information in electronic form. Electronic acquisition is desirable only when the agency's use of the information is automated. When most providers of information ("filers") are technologically sophisticated, and private sector intermediaries do not already perform a conversion and submission role, it is appropriate for agencies to require filers to submit information electronically, after developing standard formats in consultation with the filer community, and after appropriate testing and transition periods. An important part of cost/benefit analysis for designing electronic filing programs is to understand how costs of changing to standard formats will be borne, and to choose the most cost effective way to standardize or handle different formats.

3. Agencies initiating electronic acquisition programs should explore technologies to facilitate electronic filing by small or unsophisticated entities, including the use of "smart forms." When a significant proportion of the filer community is technically unsophisticated, electronic acquisition is feasible only through intermediaries. In such cases, agencies should create economic incentives for electronic filing rather than mandating it. Part of the economic incentive to file electronically under voluntary electronic acquisition programs can be the imposition of a fee, on technologically sophisticated filers able to bear the costs, for filing on paper.

The report considers electronic acquisition policy and legal issues in §V(E), and format standardization issues in §VI(A).

C. Release of Information in Electronic Form

Agencies maintaining information in electronic form should release information electronically at one or more of three levels, based on statutory mandates to release information, present practices with respect to paper forms of the information, and the costs and benefits of replacing or supplementing these paper information products with new electronic products having essentially the same content.

1. When publishing is mandated by statute or when paper publishing exists, agencies should promote electronic publishing of the information unless the cost/benefit analysis suggests offering a lower level of electronic release.

2. When a statute mandates public reference room disclosure, or paper products presently are made available through a public reference

room, agencies should provide electronic disclosure in public reference rooms, and should release information electronically in a bulk form easily usable by electronic information resellers. Such agencies should consider the costs and benefits of upgrading to electronic publishing.

3. In other instances, agencies maintaining information in electronic form should provide for access to such information in electronic form in response to FOIA requests, and consider the costs and benefits of upgrading release of appropriate parts of this information to electronic disclosure through public reference rooms and wholesaling in electronic bulk form to private sector requesters

The report considers electronic release policy and legal issues in §V(F).

The nature of electronic publishing initiatives by federal agencies should depend on the content of the information,[549]. and its value in promoting meaningful public involvement in the functions of government or in complying with law. Agencies should evaluate possible new electronic information products in a three step process, working from a baseline of traditional paper information products and evaluating costs and benefits of electronic information products with essentially the same content. The first step in the evaluation process should be to identify the form in which information that would be contained in a new electronic information product currently is released: (1) released only in response to FOIA requests; (2) released through a public reference room or some similar means that facilitates public access; or (3) published and distributed by the government or by the private sector.

The second step is to identify the benefits and costs of replacing or supplementing existing means of release with different forms of electronic release, specifically including: (1) release of electronic information only in response to FOIA requests; (2) release of electronic information only in bulk or only through public terminals in public reference rooms; or (3) electronic publishing, involving on-line, dial-up disclosure or sale and distribution of magnetic optical disks formatted so as to permit easy retrieval on a small computer. An electronic information product should not be proposed by an agency unless the cost/benefit analysis demonstrates that the electronic alternative analyzed is superior to existing means.

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[549] House Policy Report, at 9 (general public availability of information is a principal goal of governmental information policy, however, information should not be made available if there is legitimate governmental or private interest opposing disclosure).

In some cases of course, a new electronic information product involving publishing is warranted despite the absence of a comparable paper product. One clear example is the electronic database of hazardous materials explicitly mandated by the Superfund Amendments. In other cases there is no statutory mandate but the benefits of a new product are appreciable and the costs are so much lower than for a paper equivalent that a new product is warranted. An example is the Federal Energy Regulatory Commission's electronic bulletin board of commission documents.

Three categories of information are useful, the highest level involving retailing, publishing, or dissemination; an intermediate level involving wholesaling, or public reference room disclosure; and the lowest level involving ad-hoc access in response to discrete requests.

Electronic publishing (dissemination) is the highest level of electronic information release. It typically includes dialup access to databases maintained by the government or the private sector, or ready availability of data on disks or tapes in a form that can be used immediately on a small computer using accompanying or commercially available software. Electronic publishing is warranted when agencies are expressly required by statute to provide for electronic publishing, as under the Superfund Amendments or the 1987 EDGAR legislation. In other cases, a statutory mandate for, or a long practice of, paper publishing raises a presumption that electronic publishing should be viewed favorably. Examples include information contained in the Congressional Record, the Federal Register, codifications of statutes, regulations and judicial opinions, economic statistics, weather forecasts and warnings, the contents of regulatory dockets, information to promote regulatory compliance and patent information. When publishing is mandated by statute or when paper publishing exists, agencies should promote electronic publishing of the information unless the cost/benefit analysis suggests offering a lower level of electronic release.

Deciding to "promote" electronic publishing under this recommendation does not necessarily mean a direct, retail, electronic publishing and distribution role for the government, if private sector electronic publishing activities and commitments are more cost effective. (see Recommendation E) Electronic publishing contemplated by this recommendation also can occur through depository libraries;[550] for example, through disclosure terminals in, or dialup disclosure through, depository libraries.

In many cases, it is appropriate to release both paper and electronic versions of the same information, even though costs almost certainly will be higher than for either form alone.[551]

Electronic disclosure through public reference rooms or through purchase of tapes or disks with aggregate data is an intermediate level of electronic release. This level of release is presumptively appropriate when statutes explicitly require disclosure of paper information in public reference rooms or when there is a long practice of making it available through that channel. Tariff information is included in this category, though it possesses special legal characteristics.[552] When paper information is provided through public reference rooms, agencies also should consider the costs and benefits of upgrading to electronic publishing.

Recommendations A and B(3) cover agency obligations under the FOIA. Agencies also should consider the costs and benefits of upgrading release of information presently disclosed only in response to discrete FOIA requests to electronic disclosure under Recommendation D(2) or electronic publishing under D(1).

D. Roles of Public and Private Sectors

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[550] *See* Management of Federal Information Resources, 50 FED.REG. 52,736, 52,748 (1985) (ensuring availability of government "publications" to depository libraries, which ensures minimum level of public availability).

[551] House Policy Report, at 11 (because not all users are willing or able to use computer record systems agencies should provide hard copies of the information maintained electronically).

[552] Access to FMC tariff information has a special legal character. Only the FMC can certify that a rate in a tariff has been filed properly and is in effect. Such "certification" is required in private litigation over rates. In this sense, access to FMC tariffs is necessary, and it may be impermissible for FMC to recover its full costs for providing the information in electronic form. But if the information is available to some people at less than full cost, it may not be permissible to charge higher prices to other requestors. This character of tariff information arguably militates placing it in the first category rather than the second.

1. Agencies should define the appropriate roles of the public and private sectors in providing electronic information products (including telecommunications facilities, indices and retrieval software as well as raw data) justified under Recommendations B and C based on the relative costs and benefits of privately versus publicly provided information products.

2. Agencies should presume that private sector electronic information products will continue to be provided by private sector sources, and should consult with the private sector providers to explore enhancements or pricing changes that appear desirable to further agency missions. When appropriate, agencies should contract with private sector providers to increase certainty for agencies, the providers, and information consumers.

3. If new electronic means of agency acquisition or new information products are warranted by agency missions and the private sector is unwilling to make a commitment to provide them at appropriate prices, agencies should provide them, if clearly identified non-economic and economic benefits outweigh the capital and marginal costs. Agencies should not abdicate their responsibilities to ensure appropriate levels of electronic dissemination. In some cases, the economic structure of existing private institutions, including economic or technological barriers to entry, may inhibit competitive forces. Prices for electronic information may be high, inhibiting wide public access. Information content or retrieval methods may be inadequate. Or, there simply may be no private provider of the particular category of information. In such cases, agencies should take affirmative action to ensure appropriate levels of public disclosure. The action need not involve agencies directly in disseminating information directly to public consumers; it may involve creating incentives, including subsidies for private dissemination, free use of agency-developed software, or a commitment for the agency to restrict its own retailing of value added information.

The report considers public/private sector roles in §V(F)(1) (adding value); §V(F)(2) (retailing versus wholesaling); §V(F)(3) (pricing policies); §V(F)(4)(a)(vi) (FOIA as constraint); and §V(F)(4)(b) (pricing legal issues).

After the evaluation process contemplated by Recommendations B and C, agencies should identify electronic information products available from private sector sources, and consider explicitly the relationship between those products and natural byproducts of agency automation activities. This step necessarily involves evaluating appropriate pricing levels for the information product.

Evaluation of the respective roles of private and public sectors should begin by identifying existing paper products provided by the public sector and those provided by the private sector. In many cases, the public sector will provide only FOIA access or public reference room disclosure, and the private sector will take information released through one of those methods by the government and perform a publishing function, delivering a more easily usable product directly to consumers.

Electronic information products identified and evaluated favorably under Recommendation C(1) should be evaluated further to decide whether the public or the private sector should "manufacture" and "distribute" the product. This decision requires identifying costs and benefits associated with public sector "manufacturing" and distribution of the product compared with the costs and benefits associated with private sector "manufacturing" and distribution of the product. In this context, both "manufacturing" and "distribution" involve adding value. Manufacturing involves reformatting and structuring data and developing software to facilitate retrieval and ultimate use.

Frequently, the computer hardware and software necessary to permit effective agency use of computerized information permits, with little additional cost, public access.[553] Such agency automation byproducts may include indices and retrieval software. Thus the capital costs to the government, under Recommendation B(1)(A), may be less than capital costs to private sector providers for "manufacturing" the same information product. Usually, however, distributing the product to ultimate consumers via direct public disclosure would involve agency expenditures for communications facilities, which may not cost the government less than private sector providers.

Absolutely restricting an agency to a wholesaling function is artificial. The wholesaling concept implies that agencies release only raw data, and not add value in the form of indices, retrieval software, or dialup telecommunications links. In virtually every case, however, an agency must develop retrieval software and indices in order to make use of the raw data internally. The costs of these two types of added value will already have been absorbed by the agency. Restricting the agency from making these indices and retrieval software available to the public therefore erects an artificial barrier to public release in order to protect private markets. Moreover, it is not altogether clear that either indexes or retrieval software in electronic form can be protected from access under the Freedom of Information Act. Accordingly, it is prima facie appropriate for agencies to add value, and thus to retail, to the extent of making publicly available their own retrieval software and indices. They should, however, also make data available in a form that will facilitate private sector development of different or better retrieval methods and indexes.[554]

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[553] House Policy Report, at 11 (an agency should make reasonable attempts to allow public users to share the benefits of an automated system).

Dialup dissemination via telecommunications lines is another matter. The sophistication and cost of a telecommunications interface for an agency database varies in proportion to the number and dispersion of persons seeking access. Rarely would an agency construct a telecommunications system for its own internal use of data large enough for widespread public use. It is prima facie inappropriate for agencies to undertake large scale public dissemination telecommunications interfaces unless (1) there is reason for believing that the private sector will not provide such dissemination, (2) dissemination via depository libraries will not be sufficient in terms of the scope of information available through those intermediaries or in terms of delays before it will be available, or (3) the nature of the information places it in the highest category warranting public expenditure to make it widely available.

Agencies should distinguish between that part of electronic publishing that involves adding value in the form of search and retrieval software and indices, from that part of electronic publishing that involves providing telecommunications disclosure. Such a distinction permits a principled distinction to be drawn between easy-to-use electronic disclosure in an agency reading room, and nationwide dial-up disclosure. One useful approach may be to rely on the private sector to handle electronic communications between the public and agency databases, to administer cost recovery user-fee systems,[555] and to offer private enhancements to agency supplied information.

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[554]. House Policy Report, at 12 (this is a means of providing fair competition between agencies and the private sector).

[555]. *See* House Policy Report, *supra* note 124, at 10, 12 (user fees should be based on the cost of dissemination and should not be used to prevent agencies from complying with statutory requirements to maintain the public availability of government information).

In some cases, the overall cost/benefit analysis of electronic publishing will suggest a government subsidy for private information providers rather than direct performance of the entire electronic publishing activity by the agency itself.

Making government information decisions depend on existing private sector activity is controversial because it may result in establishing artificial policy-based restrictions on government dissemination of public information in order to protect private markets. Yet, Section V(F)(2) offered the example of federal court of appeals opinions, published by the private sector but not by the public section. As that discussion concluded, such a policy of government abstention is appropriate in some circumstances. No apparent benefits would result from the federal courts deciding to publish a competing set of court of appeals opinion reporters in paper; nor would there be apparent benefits from the federal courts' undertaking to publish the opinions electronically. Costs to the court system and to the current private vendors would increase if such government competition were to occur. This conclusion would change only if some new computer technology should evolve and be widely available to the consumers of this information and the existing opinion publishers did not embrace the new technology for some reason.

Agencies should presume that private sector electronic information products will continue to be provided by private sector sources, and should consult with the private sector providers to explore enhancements or pricing changes that appear desirable to further agency missions. When appropriate, agencies should contract with private sector providers to increase certainty for agencies, the providers, and information consumers.

Even when the government undertakes new electronic acquisition or release activities, existing or new private sector electronic information products will exist.

Electronic information policy should seek to mobilize market forces to ensure availability of information at a price no greater than distribution costs resulting from the best available technology. Diversity of electronic information products is desirable. It is also desirable to enable market forces to improve efficiency and reduce price. Agencies should not frustrate market forces by protecting markets for information to create a monopoly for their own automated systems, or to protect markets for contractor systems.[556] In some cases improved or cheaper public disclosure may be the natural byproducts of agency automation. When that is the case, agencies should consider carefully how improved disclosure can be obtained without driving private enterprise out of the market. Agencies also should recognize the social costs of "dumping" information products at prices lower than those necessary to encourage private capital investment. Section V(F)(4)(b) explicitly proposes a method for setting prices for government information products that serve these objectives.

Retailing and wholesaling electronic information release are not mutually exclusive: the government might retail to some degree but also wholesale to private sector information resellers who would create retail information products different from those offered by the government.[557] This is expressly contemplated by Recommendation D(2).

For example, agencies might engage in electronic publishing, providing direct "retail" public disclosure, while still preserving opportunities for private enhancements such as "one stop shopping" for wider categories of information or improved search and retrieval techniques.

Procurement regulations can inhibit the kind of consultation that is desirable. For example, brand-specific procurement requires special justification,[558] although "off-the-shelf" software is favored and compatibility with existing systems also is favored.[559] Moreover, agencies are restricted from talking to potential bidders.[560]

Contracts with private electronic information vendors also may have limits as policy tools, as explained in §V(F)(4)(c).

E. Determination of Costs and Benefits in

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[556]. House Policy Report, at 13.

[557] House Policy Report at 12 (Recommendation F(2): agency information programs should allow private sector role).

[558] 41 C.F.R. §201-11; 48 C.F.R. §6.303.

[559] 41 C.F.R. 201-8.1, 201-24.207; 48 C.F.R. Parts 10, 11.

[560] *See* 41. C.F.R. §201-1.601; 48 C.F.R. 1.602-2(b), 3.101-1, 15.402(b), 15.413, Subparts 4.4, 5.4.

Evaluating Available Electronic Information Products

1. Agencies should take into account the following costs in decisionmaking processes suggested in Recommendations B, C and D:

a. Capital costs to the agency of establishing the product, and the probable economic life and other uses over which the costs should be allocated;

b. Capital costs to information consumers to utilize the product, and the probable economic life and other uses over which these costs should be allocated;

c. The marginal costs to the agency for user access;

d. Marginal costs to users for obtaining the information;

e. Unrecovered costs associated with existing government or private sector capital that would be made obsolete by the new product; and

f. Capital and marginal costs to consumers of substitute sources of information if the product is launched but not maintained or funded to permit its intended benefits to be realized over its planned term.

2. Agencies should take into account the following types of benefits in decisionmaking processes suggested in Recommendations B, C and D:

a. Cost avoidance associated with eliminating the cost of producing existing paper products;

b. Cost avoidance associated with agency and consumer costs of making and responding to paper FOIA requests;

c. Cost avoidance associated with agency and consumer costs of retrieving information from and maintaining public reference rooms;

d. Increase in the number of interested persons having access to information;

e. Improvements in the utility of information for its intended purpose because of improved organization and retrieval possibilities; and

f. Reductions in delays associated with transferring information from an agency to eventual consumers.

3. Cost-benefit analyses should take into account FOIA obligations. In designing electronic databases, agencies should consider explicitly

the types of FOIA requests likely to be received for data in the database. Insofar as it is consistent with agency mission performance, databases should be designed so as to facilitate, or at least not to impede, FOIA access. The rule of thumb should be that it should not be any more difficult for FOIA requesters to obtain data after automation than before.

4. In some cases, effective design, motivated by responsiveness to agency missions, or by making information effectively available electronically to a wider spectrum of the citizenry, will require some sacrifices in FOIA retrieval capability. In these cases, agency designers should consider how FOIA requests can be satisfied consistent with the spirit of the Act. This might mean budgeting for higher costs of satisfying FOIA requests that should not be shifted to requesters because it would increase the cost of searches above costs of paper retrieval. Or, it might involve making raw data available on magnetic or optical disk to requesters along with retrieval software so that requesters can massage the data and effect their own retrievals.

5. In other cases, new electronic information products may reduce costs, to both requesters and agencies, of FOIA requests. This would occur, for example if certain information were published electronically or disclosed electronically in a public reference room rather than only through a paper FOIA request, as contemplated in Recommendations C(2) and C(3).

The report considers cost/benefit factors in §V(D).

The evaluation process proposed in Recommendations C and D presupposes the existence of a cost and benefit framework to guide the evaluation. Specific costs and benefits obviously will be different for each proposed information product. Certain categories of costs and benefits should be considered in every case, however.

Costs are easier to measure and compare than benefits because of the existence of a common monetary denominator. Benefits are inherently difficult to quantify, but they can be identified.

Recommendation E(2) emphasizes cost avoidance. Cost reduction permitted by a new information product is considered as a benefit in this analytical framework. Alternatively it could be considered as a cost with a negative sign to permit dollars to be traded off against dollars. Benefit categories E(2)(b) and (c) would be associated with upgrading the level of information release from ad-hoc FOIA access to electronic disclosure in a public reference room and upgrading paper public reference room disclosure to electronic publishing.

F. Monopoly Over Public Information

No federal agency should grant monopoly power to a private firm over public information in possession of the agency.[561]

The report considers monopoly issues in §V(F)(1).

Agencies may be tempted to grant monopolies over electronic information to encourage private sector entities to add value or to support agency price levels necessary to recover capital costs. Monopolies inhibit market forces and reduce efficiencies and innovation available through the marketplace, and are difficult to maintain without interpreting the FOIA in a way inconsistent with Recommendation A.

In some cases, however, agencies may wish to encourage voluntary participation in electronic acquisition programs by giving participants preferential rights to electronic information. Such preferential rights may be characterized as a kind of monopoly, but nevertheless may be warranted when they are clearly justified in terms of participation incentives and are temporary in nature.

G. Format of Information

Agency electronic acquisition and release systems should incorporate state-of-the-art technology as to security, format standards, and telecommunications techniques.

2. Agency electronic acquisition systems should include appropriate access control and other techniques to minimize security problems.[562]

3. Agencies should seek to develop electronic information formats through existing standards efforts such as ANSI X.12 (EDI) before embarking on sui generis format definitions.[563]

4. Agencies should use Public Data Networks whenever possible rather than developing their own communications links for public filers or consumers. Telecommunications systems adequate for wide public dissemination rarely are a byproduct of agency automation efforts.

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[561] *See* House Policy Report, at 12, 13.

[562]. 1985 OMB Guidelines, 50 FED.REG. at 52,742.

[563] *See* ACUS Recommendation 78-4 , 1 C.F.R. §305.78-4, concerning agency coordination with private voluntary consensus standards organizations.

Many such telecommunications systems exist, however, easily accessible by ordinary telephone from anywhere in the world. Agencies can make arrangements with such Public Data Networks to aggregate information for electronic acquisition programs, or to provide wide public disclosure for electronic release programs.

Security is discussed in §V(C) of the report. Format standards are discussed in §§II(B)(3) and VI(A). Public Data Networks and their use are discussed in §§II(B)(2) and VI(E).

H. Administrative Procedure Act Proceedings

Agencies should experiment with electronic means of providing public participation in rulemaking and adjudication under sections 553, 554, 556 and 557 of the Administrative Procedure Act, making suitable provisions for those wishing to participate but lacking the means to access the electronic information.

The report considers electronic dockets in §V(F)(4)(a)(vii). A few agencies are contemplating exchanging information electronically in the course of rulemaking or adjudicatory proceedings. Ultimately, there is no reason why the Federal Register cannot be published electronically as well as in its present paper form. Such initiatives are desirable and further the purposes of the publication and public participation provisions of the APA. No legislation is required until further experience occurs with such concepts.

I. Government-wide Electronic Information Policy

1. A government-wide electronic information policy is desirable to afford guidance to agencies. Such a policy should articulate goals consistent with those expressed in Recommendations A to H.

2. OMB should develop guidelines for agency electronic acquisition programs as well as for electronic release. These guidelines should address with particularity cost-benefit and funding problems and offer guidance on how consultation between agencies and private sector information providers can be accomplished consistent with procurement and contracting regulations.

3. The most appropriate role for the Congress is to make the larger value judgments involved in formulating government-wide policy. The Congress should decide the degree to which, and the circumstances under which, the government should hold back its own value-added information products in order to protect markets for the private sector.

4. Instead of micromanaging agency electronic acquisition and release programs, the Congress should exercise oversight of agency compliance with generic policy guidelines, including scrutiny of agency classification of information types as suggested in recommendation C, and agency consideration of private sector capacity to provide appropriate service and price levels. Agencies are in the best position to assess these factors, subject to appropriate Congressional oversight. When agencies have offered rational justifications for their electronic information programs, the Congress should defer to agency judgment.

J. National Institute of Standards and Technology

The National Institute of Standards and Technology should continue to work with USPTO to advance optical disk storage technology, and should continue and intensity its effort to inform agencies about commercially available products and services to facilitate electronic acquisition and communications.

The report considers format standardization in §VI(A) and standard setting and technical information in §VI(B).

NIST is continuing its effort to develop "FIPS PUB" standards (including those for laser disk technology) for use by government agencies in electronic systems.[564] The Government Open Systems Interconnection Profile ("GOSIP"), version 1.0, was published in the Federal Register for comment in 1987.[565]

K. Administrative Conference of the United States

1. The Administrative Conference should continue to facilitate government-wide consideration of appropriate electronic information policy and technology alternatives.

2. The Administrative Conference should develop resource materials for agencies to use in evaluating Artificial Intelligence techniques for incorporation in agency information management systems.

3. The Administrative Conference should continue to monitor major agency electronic acquisition and dissemination systems and prepare updates from time to time on the issues identified in this report.

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[564] *See* FIRMR, 41 C.F.R. Subpart 201-8.1, especially §201-8.102-1.

[565] 52 FED.REG. 41488 (Oct. 28, 1987).

The Administrative Conference should develop resource materials for agencies to use in evaluating Artificial Intelligence techniques for incorporation in agency information management systems.

While it may not be feasible or appropriate for ACUS to maintain a library of information, ACUS could develop indices of agency personnel with experience in electronic acquisition and dissemination systems, agencies providing services and equipment to other agencies, whether on a cost reimbursement basis or otherwise, and technical references, especially on Artificial Intelligence and Expert Systems, and all relevant laws, regulations, OMB circulars and policy statements government electronic system acquisitions. Such ACUS activity would be of particular use to smaller agencies like the FMC.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
RECOMMENDATION 88-11

NEITHER COP NOR COLLECTION AGENT: ENCOURAGING ADMINISTRATIVE SETTLEMENTS BY ENSURING MEDIATOR CONFIDENTIALITY

by

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Washington, D. C.

November 15, 1988

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Proposed Recommendation of the Administrative Conference of the United States

ENCOURAGING SETTLEMENTS BY PROTECTING MEDIATOR CONFIDENTIALITY

RECOMMENDATION

Model Rule

§ xxx.1 Introduction; Encouraging Settlement; ADR Techniques

§ xxx.2 Definitions

§ xxx.3 Applicability of the Rule

§ xxx.4 Neutral Impartiality and Confidentiality of Settlement Negotiations

§ xxx.5 Agency Records

Settlements are Essential to Achieving Administrative Goals

The resolution of issues through negotiations among the affected parties has long been recognized as an essential ingredient of the administrative process. The influential Attorney General's *Manual on the Administrative Procedure Act* explained in 1947 that

> [t]he settlement of cases and issues by informal methods is nothing new in Federal administrative procedure. In its Final Report, the Attorney General's Committee on Administrative Procedure pointed out ... that "even where formal proceedings are fully available, informal procedures constitute the vast bulk of administrative adjudication and are truly the lifeblood of the administrative process".[1]

To that end, the Administrative Procedure Act itself specifically provides for the settlement of adjudicatory proceedings.[2]

EPA, for example, estimates that about 95% of its enforcement cases are settled through negotiations between the government and the alleged violator.[3] Interestingly, this rate is remarkably close to the percentage of Federal cases that are resolved short of disposition by the courts.[4] Thus, settlements continue to play a crucial role in resolving administrative adjudication. Indeed, without it, the process would bog down, and agencies would be severely hampered in achieving their goals. Moreover, the costs of processing cases would escalate substantially.

Settlements bring to bear firsthand, direct information on a problem and foster creative solutions that would be difficult to achieve without the concurrence of the parties. Moreover, an agreement reached through procedures ensuring adherence to existing law and policy result in decisions being made far faster and with far fewer resources than if the matter has to be resolved through formal litigation. These agreements are not only politically acceptable, they affirmatively help the agency and the affected parties accomplish their designs. Thus, for example, the Administrative Conference[5] and the former director of Superfund enforcement have found that EPA must rely on more voluntary settlements if it is to achieve the requisite cleanup; without them, the trust fund, large as it is, will be prematurely depleted.[6]

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[1] United States Department of Justice, Attorney General's on the Administrative Procedure Act 48 (1947), reprinted in Administrative Conference of the United States, Federal Administrative Procedure Sourcebook 51, 97 (1985).

[2] Section 5(b), codified as 5 U.S.C. § 554(c) provides:

The agency shall give all interested parties opportunity for --

(1) the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment when time, the nature of the proceeding, and the public interest permit; and

(2) to the extent that the parties are unable so to determine a controversy by consent, hearing and decision ....

[3] Environmental Protection Agency, Guidance on the Use of Alternative Dispute Resolution in EPA Enforcement Cases, reprinted in ACUS, Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution 737, 739 (1987).

[4] See, e.g., Galanter, Reading the Landscape of Disputes: What We Know and Don't Know (and Think We Know) About Our Allegedly Contentious and Litigious Society, 31 UCLA L. Rev. 4 (1983).

[5] Recommendation 84-4, 1 CFR § 305.84-4.

[6] Lucero, Son of Superfund: Can the Program Meet the Expectations, 5 Enviro. For. 5 (1988).

Structured Processes in Aid of Settlement

Congress intentionally left the agencies free to develop the precise manner by which they implement the opportunity for settlement.[7] Thus, there is no one, accepted settlement process nor even guidelines within the APA or administrative law generally. Most settlements occur simply though ad hoc negotiations among the lawyers for the parties, generally on the eve of hearing. Although agencies have used a variety of procedures to help settle cases,[8] until recently little attention was paid to specific processes that foster both more and better settlements.

Some commentators caution, however, that settlement must not become an end in itself, a means of managing the docket at the cost of subverting established law.[9] Briefly stated, their concern is that care must be taken to ensure that public rights are not compromised simply to reach closure. Rather, decisions by courts -- and, by extension, agencies -- made in formal proceedings protect societal values and provide the norms that guide future conduct and by which future disputes will be resolved.[10] This relationship between formal decisions and settlements means that when developing settlement policies, agencies must determine whether a potential settlement is within its statutory mandate and existing policies or whether the question is sufficiently unclear that an authoritative decision is needed to resolve the matter and provide guidance for resolving similar cases in the future.

EPA has been a leader among the agencies in establishing procedures to foster responsible settlements while maintaining an aggressive enforcement program. For example, the Agency announced that a "fundamental goal" of its Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) enforcement program "is to facilitate voluntary settlements,"[11] and it issued a general settlement policy designed to increase the participation of potentially responsible parties in response actions.[12] The approach met with favor: "Congress recognized the value of enhancing the settlement process"[13] by enacting the Superfund Amendments and Reauthorization Act of 1986 (SARA). EPA recently noted that SARA

> maintains the importance of a strong Superfund enforcement program. In particular, SARA emphasizes the importance of entering into negotiations and reaching settlements with potentially responsible parties (PRPs) to allow PRPs to conduct or finance response actions. SARA generally codified the Agency's Interim CERCLA Settlement Policy but also established some new authorities and

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[7] Attorney General's Manual, supra note 1 at 48.

[8] For a survey of such techniques, see Harter, Points on a Continuum: Dispute Resolution and the Administrative Process, 1986 ACUS 165, 240.

[9] Edwards, Alternative Dispute Resolution: Panacea or Anathema?, 99 Harv. L. Rev. 668 (1986); Fiss, Against Settlement, 93 Yale L. J. 1073 (1984); Schoenbrod, Limits and Dangers of Environmental Mediation: A Review Essay, 58 N.Y.U. L Rev. 1453 (1983).

[10] The Attorney General's Manual, supra note 1, was of a similar view when it said

> Where an agency believes that the informal settlement of an alleged violation or certain classes of violations will not insure future compliance with law, it would be justified in concluding that such settlement by consent would not be in the public interest.
> At 49-50.

[11] EPA, Superfund Program, Interim Guidance on Notice Letters, Negotiations and Information Exchange, 53 Fed Reg. 5298 (1988).

[12] 50 Fed. Reg. 5034 (1985).

[13] Memorandum from J. Winston Porter, Assistant Administrator Office of Solid Waste and Emergency Response and Thomas L. Adams, Assistant Administrator for Enforcement and Compliance Monitoring, Interim Guidance: Streamlining the CERCLA Settlement Decision Process (February 12, 1987) at 2.

procedures that were designed to facilitate settlements.[14]

Section 122 of SARA, like the APA, explicitly authorizes settlements. It provides that the agency

> may enter into an agreement with any person ... to perform any response action ... if [it] determines that such action will be done properly by such person. Whenever practicable and in the public interest, as determined by the [agency], the [EPA] shall act to facilitate agreements under this section that are in the public interest ... in order to expedite effective remedial actions and minimize litigation.[15]

The statutory structure of SARA,[16] and the informal processes that have grown up around the resolution of other issues, is to encourage direct negotiations among the parties.[17] Other than creating a hospitable environment, however, neither SARA nor informal practice provide other means of enhancing the potential for reaching agreement once negotiations are undertaken. Yet, a vast literature has developed exploring the use of alternative means of dispute resolution, many of which are specifically designed to help the parties negotiate a mutually satisfactory agreement.[18]

The Administrative Conference of the United States has formally recommended that agencies use ADR techniques in a variety of contexts for resolving issues in controversy.[19] It found that in appropriate circumstances these procedures "have yielded decisions that are faster, cheaper, more accurate or otherwise more acceptable, and less contentious"[20] than those reached by traditional processes. Thus, many of these techniques operate to enhance a period of negotiation, to stimulate the possibility of reaching agreement within the confines of the agency's authority and policy.

To tap this potential, the Administrator of EPA sent a memorandum to the Assistant Administrators and Regional Administrators to "encourage the use of alternative dispute resolution (ADR) [techniques] in EPA enforcement actions."[21] He continued,

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[14] EPA, supra note 11.

[15] 42 U.S.C. § 9622(a).

[16] To the end of fostering agreements, SARA provides a "formal" period of negotiation as part of the settlement process. 42 U.S.C. § 9622(e)(2). If EPA determines that a period for negotiating settlements would expedite remedial action, it is to notify the parties and provide them with specified information. See Interim Guidance, supra note 11. To foster productive negotiations, the statute provides for a moratorium of 120 days on filing suits and on EPA's taking independent action once it has notified the parties that it wishes to negotiate. 42 U.S.C. § 9622 (e)(2). Under the statute, the parties have 60 days after receiving the notice to make an appropriate proposal. Thus, SARA provides a structural approach to encouraging settlement negotiations among the PRPs and EPA.

[17] Although SARA provides explicit authority to EPA to settle Superfund cases, it should be emphasized that Congress largely codified EPA's existing practice and that no additional legislation was required to authorise the agency to resolve these issues through negotiation and settlement.

[18] Administrative Conference of the United States, Bibliography: Dispute Resolution in the Federal Government (1988); Bingham, Resolving Environmental Disputes: A Decade of Experience (1986) (Bibliography) , Goldberg, Green, and Sander, Dispute Resolution (1985); and Bureau of National Affairs, Dispute Resolution Report.

[19] Agencies' Use of Alternative Means of Dispute Resolution, 1 CFR § 305.86-3; Alternatives for Resolving Government Contract Disputes, 1 CFR § 305.87-11; Procedures for Negotiating Proposed Regulations, 1 CFR §§ 305.82-4, 85-5; Negotiated Cleanup of Hazardous Waste Sites under CERCLA, 1 CFR § 305.84-4; Resolving Disputes under Federal Grant Programs, 1 CFR § 305.82-2.

[20] Agencies' Use of Alternative Means of Dispute Resolution, 1 CFR § 305.86-3.

[21] Memorandum of February 2, 1987, reprinted in ACUS, Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution 809 (1987).

* * *

> I want to encourage your support and active participation in the promotion of this concept.
>
> ADR is the use of third-party neutrals to aid in the resolution of all or part of a dispute. Examples of ADR techniques include arbitration, mediation, mini-trials and fact-finding. In recent years these techniques have gained increasing support and use in resolving private commercial disputes. EPA is already applying ADR in various contexts: negotiated rulemaking, certain Superfund sites where a facilitator is aiding negotiations between EPA and the community, and RCRA siting.[22]

EPA then issued a document entitled *Guidance on the Use of Alternative Dispute Resolution in EPA Enforcement Cases.*[23] It sets forth EPA's policy on the use of ADR, describes applicable types of ADR and the characteristics of cases for which its use might be appropriate, formulates case selection procedures, establishes qualifications for third party neutrals, and furnishes model case management procedures that use ADR techniques. The Guidance defines the role of a neutral third party in ADR procedures. The particular emphasis, however, is on ADR techniques in which the neutral third party aids the parties in resolving the issues in controversy through agreement, as opposed to the neutral's making a decision that is binding on the parties.

Briefly, these techniques are:[24] In **mediation and facilitation**, the neutral third party works with the parties in helping them negotiate a settlement; the process of mediation is described in more detail below.[25] In **non-binding arbitration** the parties present evidence and arguments to the neutral who makes a tentative decision concerning the resolution of issues. The parties may, and often do, accept the decision and abide by it. But, since the arbitrator's opinion is not binding on anyone, even if it is rejected it helps the parties resolve the issues through negotiation by providing a benchmark as to how the matter might be resolved if it were to go to hearing. In **factfinding** the neutral is asked to review a factual matter and, like non-binding arbitration, provide an opinion as to the issues specified. It customarily uses an investigative process that uses informal procedures. Like non-binding arbitration, its use in inducing settlements is to provide a framework for the negotiations. In a **mini-trial** the parties present summaries of their cases in the presence of representatives who have the authority to settle the matter. The neutral presides at the hearing. Following the presentations, the representatives of the parties seek to negotiate a resolution of the issues. The neutral may serve as a mediator to help those discussions or, if asked by the parties, render an informal opinion as to the outcome which will then be taken into account in subsequent negotiations.

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[22] Id.

[23] EPA, supra note 3.

[24] For a more elaborate description, see EPA, supra note 3 at 742-743 and Harter, supra note 8.

[25] See page 5, infra.

The terms facilitation and mediation are often used interchangeably. In both the neutral assists the parties in negotiating an agreement. To the extent there is a difference, a facilitator tends to run meetings and generally provide the framework for negotiations, whereas a mediator tends to be more actively involved in working with the parties. Because the term "mediation" is so closely associated with labor relations and other situations in which there are only a few identified parties, in some instances concerning issues of public policy, those participating in the negotiations have preferred the term "facilitator" regardless of the degree of the neutral's involvement. Instead of relying on the terms to differentiate between distinct processes, the parties and the neutral need to define -- or evolve into -- the role the neutral will play in the negotiations. For these purposes the two terms can be viewed as synonymous.

The Role of the Mediator

Professor Lon Fuller, one of the early, astute observers of the dispute resolution process, succinctly described the role of a mediator in improving negotiations:

> Where the bargaining process proceeds without the aid of a mediator the usual course pursued by experienced negotiators is something like this: the parties begin by simply talking about the various proposals, explaining in general terms why they want this and why they are opposed to that. During this exploratory or "sounding out" process, which proceeds without any clear-cut offers of settlement, each party conveys -- sometimes explicitly, sometimes tacitly, sometimes intentionally, sometimes inadvertently -- something about his relative evaluations of the various items under discussion. After these discussions have proceeded for some time, one party is likely to offer a "package deal," proposing in general terms a contract that will settle all the issues under discussion. This offer may be accepted by the other party or he may accept it subject to certain stipulated changes.
>
> Now it is obvious that the process just described can often be greatly facilitated through the services of a skillful mediator. His assistance can speed the negotiations, reduce the likelihood of miscalculation, and generally help the parties to reach a sounder agreement, an adjustment of their divergent valuations that will produce something like an optimum yield of the gains of reciprocity. These things the mediator can accomplish by holding separate confidential meetings with the parties, where each party gives the mediator a relatively full and candid account of the internal posture of his own interests. Armed with this information, but without making a premature disclosure of its details, the mediator can then help to shape the negotiations in such a way that they will proceed most directly to their goal, with a minimum of waste and friction.[26]

In the first instance, especially in complex matters involving public policy, a mediator[27] may help identify who should participate in the negotiations by making a concerted effort to determine who will be affected by the ultimate decision. Once the parties[28] are identified, the neutral may work to develop the framework for negotiations. For example, it may be appropriate to conduct negotiations among only the private parties,[29] between the group of private parties and the government,[30] or among all of the parties at once.

Proposing to negotiate with a putative adversary is frequently taken as a sign of weakness by some litigators and public officials.[31] And it is certainly not uncommon to find at least some of the parties "grandstanding"[32] about the rectitude of their cause while rattling sabres over their unquestionable victory before the tribunal. The parties themselves often find it difficult to initiate negotiations in this environment. A mediator can help establish the negotiations by talking with the parties one after another. In these individual meetings, the mediator explores the benefits of direct negotiations, the potential adverse consequences of not settling, the issues that might be discussed, at least preliminarily, in the negotiations, and some potential resolutions of those issues. Armed with this information, if negotiations look productive, the mediator can then propose that the parties attempt to bridge their differences through negotiations. In that way, no party has to take the first step, at least publicly; even though one party likely suggested initially that the mediator review the potential for negotiations, the others do not need to know just who took the leap. Thus, the mediator can make it "safe" for parties to begin the process and commitment to negotiation. That alone can be a major initiative in fostering settlement.

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[26] Fuller, Mediation -- Its Forms and Functions, 44 S. Cal L. Rev. 305 (1971), reprinted in Goldberg, Green, and Sander, Dispute Resolution 104, 105-106 (1985).

[27] A neutral whose task is to identify the parties that would need to participate in the dispute resolution proceeding, assess the issues to determine whether some form of ADR would be appropriate, and contact the parties to secure their interest in participating is customarily called a "convenor". That person necessarily gets to know the parties and the issues, so he or she also usually, but not always, serves as the mediator if a mediated negotiation is undertaken. As a result, the person who puts together the negotiations is also commonly called the mediator. For these purposes, the important feature is the relationship of the parties to the neutral, regardless of name or function.

[28] In some mediations involving policy matters there may not be "parties" in the normal sense in that they are named in an adjudicatory proceeding. Rather, the term "party" in these negotiations means someone, or a representative of a group of people, who is interested in the outcome of the proceeding and who participates directly in the negotiations.

[29] For example, in a Superfund site, the mediator may work only with the PRPs in developing a potential remedial plan or allocating responsibility among the PRPs.

[30] The parties to a negotiation may be a group of private parties on the one hand and a government agency on the other. In a Superfund case, for example, the mediator may assist the negotiations between the PRPs as a unit and EPA.

As part of this process, and continuing as part of the mediation itself, the mediator will explore with the individual parties what their real *needs* or *interests* are, not what their litigating position will be. Given the law and the facts, each party must make an assessment of what the potential outcome of a litigated decision might be and, given that, what their interests are.[33] As one observer noted, parties will often share things with the mediator that they are unwilling to discuss with each other.[34] The mediator can tease out what the parties would be willing to accept and alternative approaches that meet their needs.

With this information, the mediator can propose ideas or an outline of an approach that can provide a common framework for discussions among the parties. In a very real way, this structure can "make it safe" for the parties to talk directly and productively. During negotiations, the mediator serves as a proponent of the negotiation process, keeping the parties' attention on the task at hand and maintaining momentum, especially during the difficult times. He or she carries messages back and forth among the parties and can launch trial balloons. For example, someone may think an idea meets important needs but may be reluctant to raise it directly for fear that others may not embrace it and yet view it as something the other party will always be willing to accept.[35] To avoid being trapped the party may want the mediator to try it out on the others but without attribution. If the notion does not meet with a favorable response, no one is bound by it, even informally; if it does work, then all the parties can perfect it and claim it as their own. In this way, the parties often feel more free to raise sensitive issues and creative ideas.

A mediator also acts as an agent of reality and as an advocate. As the agent of reality, the mediator will help a party assess a proposal, need, or expectation against what is likely to happen short of agreement or how the other side will likely react: deflating grandiose ideas certainly helps secure realistic approaches. As an advocate, the mediator presents the views of others in a way that the party can analyze and hence take into account in deciding what response to make. Finally, and critically importantly, the mediator serves as a metronome by establishing and maintaining the rhythm and pace of the negotiations.

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[31] Just why this should be the case is not immediately apparent since a party with a very strong case may nevertheless wish to avoid the expense, hassle, and delay attendant to litigation and hence resolve the matter by direct agreement. Thus, whether or not someone is interested in negotiating a settlement is in fact independent of the strength of the underlying case. Be that as it may, one hears often that a party may be reluctant to initiate negotiations for fear that the adversaries will take it as a sign of weakness: the fear, rational or not, is clearly an operative fact of the litigation environment.

[32] Rogers and Salem, A Student's Guide to Mediation and the Law 64 (1987).

[33] A common example from Superfund cases is where the agency proposes a particular clean up strategy and the PRPs, or at least some of them, believe the same level can be achieved for less cost through another technology. See, e.g. Naj, How to Clean Up Superfund's Act, Wall Street Journal, September 15, 1988, at 30.

[34] McCrory, Environmental Mediation -- Another Piece for the Puzzle, 6 Vt. L. Rev. 43, 54 (1981).

[35] As with the fear of initiating negotiations, the fear parties have about making proposals because the other parties will take the proposal as an "option" they can accept later since the initiating party will always be willing to yield on it is totally misplaced. As any participant in a complex negotiation knows, a proposal may have a very short life span indeed: if it is not accepted readily, it dies. It must be raised anew if it is to be considered in the future, at which time it will be the subject of further negotiations. Any mediator has seen parties try desperately to get back to a proposal that was rejected earlier.

Throughout, however, it is important for everyone to recognize that the mediator has no power whatever: every decision is made by the parties and the parties alone. The mediator does not participate in the actual resolution of the substantive issues.

The neutral in non-binding arbitration and factfinding obviously plays a different role from that of a mediator because he or she issues a tentative decision that is then used as the basis for negotiations among the parties. The neutral in a mini-trial may or may not render such an opinion and is more likely to assume the attributes of a mediator in helping the principals reach agreement after the mini-trial is concluded. For these purposes, however, all neutrals have the common characteristic of helping the parties negotiate an agreement. The role of the neutral may vary, but in each the goal of the parties is to reach agreement, not win an adjudicatory proceeding.

Need for Confidentiality

Negotiations Generally. As the quotation from Professor Fuller[36] and the above description of the mediation process indicate, at least some of the mediation process needs to be in confidence for it to be successful. To be sure, a facilitator who runs meetings and coordinates public sessions provides a substantial benefit to negotiations by establishing an orderly process. But, many of the putative benefits of mediation can be achieved only if the proceedings are held confidential.

One of the central functions of mediation is to encourage the parties to speak candidly about their interests, needs, fears, and desires. If a party had *any* concern that what it tells the mediator in confidence or what it does in the negotiations might be revealed to its detriment, any rational person would likely not be as forthcoming -- they would want to protect against revealing too much and hence maintain an adversarial position akin to litigation.

Moreover, in some instances a party may approach negotiations not with an aim of settling the matter but of learning more about the other side; that is, they would use the mediation as a form of discovery for tactical advantage. An unwary opponent may then reveal too much to its disadvantage. Preventing the subsequent use of the information gained will go a long way towards protecting against such bad faith. Or, a party may fear that the mediator might report information learned in the negotiations to the authorities -- either voluntarily or under pressure by an agency -- and hence they would view the mediator in about the same vein as an agency investigator.[37] Confidentiality assures the parties that what is said in the discussions will be limited to the negotiations alone so they can be free to be forthcoming without fear of the mediator's reporting questionable activities.[38]

Finally, parties may be reluctant initially to engage in direct negotiations simply because they may be unsure of what they are giving up or what will happen. Providing some degree of confidentiality makes it "safer" for them to undertake the negotiations since it will protect them by ensuring that, unless they reach an agreement, nothing that goes on in the negotiations will subsequently be used against them.

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[36] See page 5 supra.

[37] In informal discussions, several PRPs have expressed reluctance to engage in mediated negotiations among the PRPs as a group for fear that EPA will seek to compel the mediator to reveal information that is disclosed during the negotiations and that that would compromise the litigating position of at least some of them should the negotiations be unsuccessful or EPA reject the agreed upon approach. Thus, they fear that the mediator would involuntarily be converted into an investigator for the agency.

[38] Rogers and Salem, supra note 32.

Communications with the Mediator. Mediation can only work as designed if the parties have confidence in the mediator's impartiality.[39] Beyond the obvious requirement that the mediator must approach the negotiations in a balanced manner, this has significant implications with respect to the need to maintain confidentiality.

First, the mediator needs to keep notes of his/her reactions, thoughts, strategy, and ideas. Although the notes are solely for the mediator's own benefit and to aid in the negotiation process, others could certainly misconstrue parts of them as indicating a bias against some party or interest. For example, the mediator may note that the position taken by a particular person may be unrealistic or too intractable, and that future work needs to be done to determine whether that party is willing to look at other means of resolving the issue; if made public, the party could feel -- reasonably or not -- that such a notation indicated a bias or hostility towards it when in fact it is made to help the mediator discharge his or her duty in a fully neutral manner. Thus, if the notes were subject to release, the mediator would likely not keep them with sufficient candor, and the process would suffer accordingly.

Secondly, if the mediator were to testify in a subsequent formal proceeding as to what went on during the negotiations, the integrity of the entire process could be jeopardized. No matter how true or objective the report, one party or another is likely to feel disadvantaged by what is said. As a result, that party may feel the mediator is biased against it, and that could adversely affect that party's entire perspective of the negotiations. For example, following a complex, protracted, but ultimately successful negotiation a question arose over the interpretation of the resulting agreement. One the parties asked the mediator to review his notes and describe his view as to the evolution and meaning of a particular paragraph in the contract. He responded that he would not meet with the one party alone since that could disadvantage the other side, but that he would meet with all the parties to see if they could work out an agreement on the contested issue; all parties then concurred in having the meeting. When the mediator reviewed his recollection of the purpose of the clause, one of the parties -- interestingly, the one making the initial request -- flatly rejected the description and said that it reflected a bias on the part of the mediator that favored the other side; because of this new, hostile feeling, the dissatisfied party began to doubt the integrity of the entire negotiation and resulting agreement.

To protect against situations like this, some argue that a mediator should not be required to testify about what went on even if all of the parties concur that the mediator should do so. The basis for the apprehension is that even though the parties may initially want the mediator to testify someone will be hurt and hence the testimony will harm the integrity of the process.[40] This concern was expressed succinctly and powerfully by a court that considered the matter in the labor context:

> To execute successfully their function of assisting in the settlement of ... disputes, the [mediators] must maintain a reputation for impartiality, and the parties to

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[39] To be sure, in some cases a mediator may be an employee or affiliated with one of the parties and hence is not impartial. An ombudsman in an organisation is necessarily such an animal. Indeed, in some instances having the mediator be close to one of the parties can help the negotiations substantially by securing the attention and willing participation of a party that may otherwise be difficult to reach. In the situation where a mediator has a potential conflict of interest, the parties should be notified at the outset so they can decide whether that person can still serve a useful role as a mediator. Moreover, the parties can then tailor their behavior accordingly.

[40] In some instances, of course, it would be perfectly appropriate for a mediator to testify without any risk to the process. An example would be when a person signing an agreement has died and the question arises over whether he actually signed it. The mediator could provide the ministerial task of testifying that indeed he did.

One way to take account of situations like this is to provide that the mediator can testify if all the parties and the mediator agree to do so.

> [mediated negotiations] must feel free to talk without any fear that the [mediator] may subsequently make disclosures as a witness in some other proceeding, to the possible disadvantage of a party to the [negotiations]. If [mediators] were permitted or required to testify about their activities, or if the production of notes or reports of their activities could be required, not even the strictest adherence to purely factual matters would prevent the evidence from favoring or seeming to favor one side or the other. The inevitable result would be that the usefulness of [mediators] in the settlement of future disputes would be seriously impaired, if not destroyed.[41]

Four Types of Potential Disclosures. Disclosure by the mediator of what went on in the negotiations, of the mediator's notes, or documents furnished the mediator by a participant in the negotiations may occur in any of four ways:

- *Voluntarily.* Without some understanding or requirement, the mediator would, of course, be free to reveal publicly what was said or done during the negotiations. As the discussion above indicates, however, that would largely destroy much of the benefit of mediation, so that it is customary for the mediator to promise the parties that he or she will maintain the confidentiality of the negotiations and not disclose anything voluntarily.

- *Request or Direction of a Third Party.* In some instances, a statute may require as a matter of law that a mediator who learns something during the negotiations must disclose that fact to the authorities. For example, many state statutes require the mediator to report evidence of child abuse that may be disclosed during a mediation; another example is where a party reveals he is about to commit a crime.

  Or, someone who was not a party may want to learn about what occurred during the negotiations because the information might be useful to that third party. For example, a company and a complainant may settle a discrimination case through mediation, and another employee may seek to learn the details of the settlement because it may be helpful to a suit that person brought against the same company.[42]

- *Request of One of the Parties to the Negotiation.* After the close of the negotiations, whether or not they successfully result in an agreement, one or more of the parties may request the mediator to testify about some aspect of the negotiations. It may concern an interpretation of the resulting agreement or even whether there was an agreement[43] or something else.

- *Request of All of the Parties.* All of the parties to the negotiations may ask the mediator to testify or otherwise describe his or her impressions about some aspect of the negotiations.

It seems clear in the abstract that ensuring the confidentiality of communications between the parties and the mediator and of the mediator's notes would help the parties negotiate an agreement. Without more, it would therefore be wholly appropriate to require categorically that that information remain sealed with the mediator. But, other considerations frequently need to be taken into account.

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[41] NLRB v. Joseph Macaluso, Inc., 618 F.2d 51 (9th Cir. 1980), quoting from Tominson of High Point, Inc., 74 NLRB. 681, 688 (1947).

[42] See, e.g., Scaramusso v. Glenmore Distilleries Co., 501 F. Supp. 737 (N.D. Ill. 1980); Branch v. Phillips Petroleum Co., 638 F.2d 873 (5th Cir. 1981).

[43] See, e.g., Drukker Communications, Inc. v. NLRB, 700 F.2d 727 (D.C. Cir. 1983).

A number of questions must also be addressed in deciding the appropriate scope of confidentiality surrounding the mediator. Who may enforce confidentiality: the parties, the mediator, a non-party participant, or conceivably someone else? And, just what is confidentiality: does it mean that it may not be revealed, period; that it may not be discovered or subject to other process; or only that it may not be admitted into evidence in an adversary proceeding? When does confidentiality apply: always; only in adversarial proceedings involving the same parties or issues; all proceedings, including subsequent mediations? May a general rule favoring confidentiality be superceded for some important reason? If so, what are the reasons and who makes the decision?

The Uncertain Legal Environment

Every Person's Evidence. The most formidable obstacle to protecting the confidentiality of communications with the mediator is the basic premise that the "public is entitled to every person's evidence."[44] Under the prevailing theory, if someone has evidence that bears on an issue before the court, a party is entitled to compel that person to provide it, absent some overriding interest or privilege. Thus, if something that was told to the mediator during the negotiations or something the mediator saw in the process would help resolve an issue before the court, unless protected by some privilege or other legal doctrine, the mediator could be required to testify. The issue might be whether the parties reached an agreement at all when one side contends they did and the other thinks not,[45] what the terms of an admitted agreement were,[46] whether the negotiations were in fact an illegal price-fixing conspiracy,[47] or whether during the negotiations one side admitted liability but now, after the negotiations have failed, repudiates it.

Settlements Have Limited Protection. Even at common law, however, negotiations between the parties aimed at settling pending litigation received at least some protection. The concern was not particularly that of fostering settlements. Rather, it was because the information derived from the negotiations may not be all that reliable since the parties may be more interested in buying peace than in the accuracy of their statements.[48] Thus, the evidence derived from settlement negotiations was excluded on grounds of accuracy and relevance, not to improve the efficiency of the process itself. As a result, an independent admission of fact made during the discussions could be admitted on traditional evidentiary grounds. Because of that, negotiations took on a game-like quality, with sophisticated negotiators qualifying statements by describing them as "hypothetical" or asserting that "this statement is without prejudice". The unsophisticated could be trapped. Moreover, the legally sophisticated would wrap the negotiations in an agreement between the parties that would define the contours of the negotiations and seek to provide blanket protection for them.

Federal Rule of Evidence 408. Federal Rule of Evidence 408 rejects the relevancy basis of excluding information derived from settlement negotiations, and is specifically aimed at stimulating settlements.[49] FRE 408 provides:

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[44] 8 Wigmore, Evidence, § 2191-92, 2286 (McNaughton rev. 1961); Branzburg v. Hayes, 408 U.S. 665 (1972); Blackmer v. U.S., 284 U.S. 421 (1932).

[45] Drukker Communications, Inc. v. NLRB, 700 F.2d 727 (D.C. Cir. 1983).

[46] See p. 8 supra.

[47] Professor Eric Green presents a number of difficult issues surrounding the confidentiality of mediated negotiations in Green, A Heretical View of the Mediation Privilege, 2 Ohio S. J. Dis. Res. 1 (1986). The example is from this article, at 13.

[48] Hoxie, Mediation Confidentiality: The Need for Protection and Its Limits, 98 Harv. L. Rev. 441 (1984).

> Evidence of (1) furnishing or offering or promising to furnish, or (2) accepting or offering or promising to accept, a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

FRE 408 protects information conveyed by a party during a settlement negotiation, and actions or conduct that occur during the negotiations, from being admitted into evidence. That is, of course, a significant step towards affording the confidentiality of mediation. But, 408 has many exceptions and limitations,[50] and hence it provides an insecure basis for protection.

First, the rule applies only to "compromise negotiations" over a disputed claim. It is therefore unclear whether it would cover negotiations aimed at resolving issues in controversy that have not yet ripened into a "dispute" of sufficient magnitude to have resulted in litigation in Federal court.[51] In particular, 408 may or may not cover the settlement of issues pending in an administrative proceeding let alone before an administrative case has been filed. One would think the theory of the rule would extend to these issues, but the rule itself does not provide comfort.

Second, Rule 408 only prevents the **admissibility** of the evidence; it does not protect against its discovery. Thus, on the face of the rule, a third party could discover what was said and done in a settlement negotiation in hopes of ascertaining admissible evidence. Several courts have extended the rule, however, and also protect evidence that is made inadmissible by the rule also non-discoverable.[52] In *Bottaro v. Hatton Associates*,[53] the court found:

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[49] 10 Moore, Federal Procedure, §

The Senate Report on the Rule said:

> This rule ... makes evidence of settlement or attempted settlement of a disputed claim inadmissible when offered as an admission of liability or the amount of liability. The purpose of this rule is to encourage settlements which would be discouraged if such evidence were admissible.
> Id. at § 408.5

[50] One exception which seems entirely appropriate is that information and data that has an independent existence and that is otherwise discoverable or admissible will remain so: it is not insulated simply because it was used in the negotiations. What might be protected, however, and what **should** be protected in any sort of mediation privilege is the fact that the document or other information was used in settlement negotiations. Thus, for example, it would be appropriate to admit into evidence an engineering drawing that was prepared years before the settlement negotiations and that played a major role in the negotiations; it would **not** be appropriate to mention that the drawing was used in settlement negotiations.

[51] Brazil, Protecting the Confidentiality of Settlement Negotiations, 39 Hastings L.J. 955, 960-966 (1988).

At least some courts appear to require at least the threat of litigation before the rule become applicable; otherwise, the negotiations are viewed simply as business discussions not subject to protection under FRE 408. Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co., 561 F.2d 1365 (10th Cir. 1977); Olin Corp. v. Insurance Co. of North America, 603 F. Supp. 445, 450 (S.D.N.Y. 1985); Cassino v. Reichhold Chemicals, Inc., 817 F.2d 1338 (9th Cir. 1987).

[52] Restivo and Mangus, Alternative Dispute Resolution: Confidential Problem-Solving Or Every Man's Evidence?, 5 Alternatives 5, 7 (May, 1984). Branch v. Phillips Petroleum Co., 638 F.2d 873 (5th Cir. 1981); Bottaro v. Hatton Associates, 96 F.R.D. 158 (E.D.N.Y. 1982).

> Given the strong public policy of favoring settlements and the congressional intent to further that policy by insulating the bargaining table from unnecessary intrusions, we ... require some particularized showing of a likelihood that admissible evidence will be generated by the dissemination of the terms of a settlement agreement.

These cases do not provide a general "settlement privilege" that will defend against any discovery request. Rather, they require someone who would discover settlement materials to make a showing of need[54] or at least that the material will lead to admissible evidence.[55]

Third, the rule protects only evidence used to prove or disprove liability or its amount. Thus, for example, if the defendant admits liability and the amount but seeks to negotiate a settlement by offering installment payments, his acknowledgement of liability is admissible: neither the claim nor its amount are contested.[56] Nor did it protect a hapless defendant who stole some property and agreed to return it in exchange for its owner dropping criminal charges; the admission implicit in the bargain was introduced in a subsequent trial since it was not made in a proceeding over a contested claim.[57]

Fourth, the rule excludes the material only with respect to proving liability. It does not ward off introduction for other purposes, such as impeaching a witness.[58] While certainly appearing neutral in the abstract, this can be a major exception to the general rule: it takes very little creativity on the part of a trial lawyer to invent an alleged inconsistency in a witness's testimony sufficient to bring the exception into play. Moreover, that the negotiation documents may be used for impeachment necessarily makes them relevant and hence subject to discovery if they can be linked to any potential witness. Fortunately, however, most courts resist such use.[59] But, evidence of settlement agreements may still be admitted for a variety of reasons, so long as one is not to prove contested liability.[60]

Fifth, the rule simply does not protect the negotiations in any forum that has not adopted it. In particular, it does not apply to administrative or legislative proceedings.

Sixth, it does not protect against anyone's voluntarily divulging publicly what went on in the negotiations, even if some of the information would still not be admissible:[61] the

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53.(...continued)

[53] 96 F.R.D. 158, 160 (E.D.N.Y. 1982).

[54] See the discussion of the protection accorded workproduct by F.R.Civ.P. 26(b)(3) infra at p. 14.

[55] As Brasil, supra note 51 at 956, has said: "[T]he weight of authority suggests that there is no generalised privilege for settlement communications and that they are discoverable, at least after a showing of substantial need."

One court was faced with a discovery request by a nonsettling defendant for the terms on which the plaintiff settled with his former cohorts. The court found that since Rule 408 did not bar the admission of settlement materials for all purposes, the defendant was entitled to discovery to determine if it might be admissible for some purposes in the trial. Bennett v. La Pere, 112 F.R.D. 136 (D. R.I. 1986).

[56] The example is from the Advisory Committee's Notes. Moore, supra note 49, § 408.7.

[57] United States v. Peed, 714 F.2d 7, 9 (4th Cir. 1983).

[58] For an extensive discussion of these exceptions to the rule that evidence from settlement negotiations is not admissible, see Brasil, supra note 51, at 966-982.

[59] Green, supra note 47, at 18.

[60] Green, supra note 47, at n.33; Hoxie, supra note 48.

[61] Freedman and Prigoff, Confidentiality in Mediation, Need for Protection, 2 Ohio S. J. Dis. Res. 37 (1986).

privacy would nonetheless be lost.

Seventh, the rule does not explicitly address the role of a neutral in settlement negotiations. Inasmuch as the purpose of the rule is to encourage settlement, one would certainly think that the presence of a neutral in the negotiations would not reduce the level of protection afforded under the rule. Interestingly, very few cases address the issue directly.[62] One case found that the presence of a conciliator in the settlement negotiations had no effect on the application of the rule.[63] But in another case the parties to a settlement retained a neutral third party to prepare a factfinding report on the effects of some price-fixing activities; the parties agreed that the report should remain confidential. The court found, however, that the parties could not contract for confidential treatment and that others should be able to obtain evidence relevant to their cause, so discovery was permitted.[64] Although perhaps troubling, this case is not direct precedent for the proposition that Rule 408 does not apply when a neutral third party assists in the negotiations.[65] The neutral in that case was employed to make a report *as a consequence of* the negotiations, not help the parties reach agreement initially. Thus, it would appear that the theory of Rule 408, as well as the one case that was found directly on point, would mean that the rule would apply to settlement negotiations in which a neutral assists.

As should be clear, FRE 408 offers protection of only limited reach. Exceptions to the seemingly broad sweep of the rule may prevent the mediator and the participants in a negotiation from achieving their expectations -- and even promises -- of confidentiality.[66]

Workproduct. Another potential source of protecting the mediator's notes and impressions of what went on in the negotiations, if not the documents furnished by the participants, is the "workproduct" exception to discovery created by *Hickman v. Taylor*.[67] The Court held in that case that the private memoranda, personal recollections, written statements of witnesses, and notes that are developed by an attorney in preparation of litigation are not protected from disclosure by the attorney client privilege. The Court continued, however, that their routine discovery would contravene the public policy: "[n]ot even the most liberal of discovery theories can justify unwarranted inquiries into the files and the mental impressions of an attorney";[68] "it is essential that a lawyer work with a certain degree of privacy, free from unnecessary intrusion by opposing parties and their counsel."[69] The Court continued with an oft-quoted passage:

> Were such materials open to opposing counsel on mere demand, much of what is now put down in writing would remain unwritten. An attorney's thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the

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[62] A Lexis search found no cases that mention 408 within 20 words of "mediator".

[63] EEOC v. Air Lines Ass'n., 489 F. Supp. 1003, 1008 (D. Minn. 1980) rev'd on other grounds, 661 F.2d 90 (8th Cir. 1981).

[64] Grumman Aerospace Corp. v. Titanium Metals Corp., 91 F.R.D. 84 (E.D.N.Y. 1981).

[65] Indeed, this case was decided by the same judge who subsequently decided Bottaro. v. Hatton Associates, 96 F.R.D. 158 (E.D.N.Y. 1982) which is often cited as one of the strongest cases in favor of protecting the full range of settlement documents from discovery absent at least a preliminary showing that discovery will lead to admissible evidence.

[66] Hoxie, supra note 48.

[67] 329 U.S. 495 (1947).

[68] Id. at 510.

[69] Id. at 510-511.

> preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.[70]

To the end of protecting against this untoward intrusion into the attorney's workproduct, the Court required a substantial showing before factual material generated by the attorney can be discovered; the "opinion workproduct" -- the attorney's mental impressions and theories -- should be available only on a truly rare showing of need.

The Federal Rules of Civil Procedure codified this holding. They provide that a party may discover documents and tangible things prepared in anticipation of trial "only upon showing [of] substantial need of the materials in preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means."[71] The protection afforded the attorney's mental impressions is categorical:

> In ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative of a party concerning the litigation.[72]

Although the full scope of the protection afforded the workproduct is not entirely clear,[73] it is independent of the attorney client privilege and belongs to the attorney, not the client.[74] Thus, at least theoretically, the attorney could refuse to reveal information developed in preparation for trial even if his client authorized, or even directed, him to do so.

The protection afforded workproduct by the Federal Rules of Civil Procedure applies to materials prepared in anticipation of litigation by a party or his representative, "including his attorney, consultant, surety, indemnitor, insurer, or agent."[75] The list does not include "mediator," and a mediator is not explicitly the "representative" of any of the parties. But, in a sense the mediator is an agent or representative of all parties to the negotiation, and to a very real extent a mediator is a "consultant" to the parties with respect to the processes of settlement. And, as the discussion above indicates, surely the mediator needs the same degree of privacy to function efficiently as does the lawyer. Moreover, the same policy that favors the ends of justice and voluntary settlement that underlies the workproduct protection of attorneys would apply equally to a mediator. Thus, it would be only a short step to apply the workproduct doctrine to a mediator, and indeed its contours fit remarkably well.

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[70] Id. at 511.

[71] F.R.Civ.P. 26(b)(3).

[72] Id.

[73] Cohn, Work Product Doctrine: protection, not privilege, 71 Geo. L. J. 917 (1982); Note, Workproduct Doctrine in Subsequent Litigation, 83 Col. L. Rev. 412 (1983).

[74] As summarised by one article:

> The attorney's "workproduct" privilege, if privilege it is, is the privilege of the attorney and not of the client, its rationale being based on the right of a lawyer to enjoy privacy in the course of preparation of his suit.

Ghent, Discovery -- Attorney's "Work Product", 35 ALR 3d 412, 423.

See also, Hiltachk, Legal Malpractice and Discovery of Opinion Workproduct in California: The Dilemma Created by Absolute Protection, 17 Pac. L. J. 1393 (1986).

[75] F.R.Civ.P. 26(b)(3).

If the workproduct doctrine were to be applied to a mediator, someone could secure documents generated in the negotiations from a mediator, but only by demonstrating particular good cause and that burden could virtually never be met if the documents were available from another source. The mediator's mental impressions of what went on during the negotiations would have a higher degree of protection, and the mediator could refuse to reveal them even if all the parties to the negotiations authorized the testimony or release of notes. The disclosures would be protected against intrusion by a party to the negotiations as well as someone who was not a participant. Although less clear, the protection would apply regardless of the issues in the subsequent litigation.[76] It would not, however, protect against the mediator's voluntarily disclosing what went on. Like Rule 408, however, it applies only to cases actually filed and even then only in Federal court or other forums with similar rules.

As discussed in the next section, at least one court has found the analogy applicable.

Adler v. Adams. One of the early examples of mediating complex public policy issues among a variety of interests involved the nature and location of Interstate 90 into Seattle. Dr. Gerald Cormick, a pioneer in the area of environmental mediation, served as the mediator. He was eventually subpoenaed to provide all documents relevant to the "negotiated compromise", including all "handwritten notes, memoranda, notes and telephone conversations, file memoranda, correspondence, and contracts of employment."[77] He was also noticed for a deposition. After reviewing the benefits of confidentiality in mediation and the promises of confidentiality that mediators make, the Motion to Quash argues that enforcing the subpoena would place the mediator in a "cruel trilemma": he would have to perjure himself; violate his ethical canons that require a mediator to maintain the confidence of negotiations; or face a prison sentence for contempt. Thus, Dr. Cormick argued that, absent compelling circumstances, discovery through the mediator should be blocked and the subpoena quashed. Even if the court did not concur as to materials exchanged between the mediator and the parties, the mediator argued that his personal notes should be protected on the basis of *Hickman v. Taylor*.

The Magistrate[78] held in an important, but unfortunately unreported order, that the mediator must furnish documents provided at meetings open to the public, since they were not secret or confidential when produced and hence should not be so regarded subsequently. The Magistrate also ordered the production of materials from a source not a party to the negotiations since that would not violate any assurances of confidentiality. The Magistrate further held that "[a]ll memoranda, notes, summaries and other documents prepared by Dr. Cormick [or his staff] and any other documents reflecting their work product" need not be produced unless it was previously made available to the general public. He thought that forcing disclosure would "undercut the effectiveness of the mediation process" and "severely inhibit the proper performance of his duties." The Magistrate noted that "any information properly sought from [the mediator] is equally available from other sources, indeed, generally from the parties to this litigation".

As for the deposition, the Magistrate noted that information as to what took place in the negotiations is available from the parties. Moreover, it would be impossible after the passage of time to sort out what happened in public meetings and what went on in private negotiations, so it would also be inappropriate to ask the mediator to testify concerning public meetings. Records of these proceedings are protected workproduct.

On review, the court found "that the Magistrate's decision properly resolves the questions presented for the reasons stated therein."[79]

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[76] "The literal language of the Rule protects materials prepared for any litigation or trial as long as they were prepared by or for a party to the subsequent litigation." FTC v. Grolier, Inc., 462 U.S. 19, 25 (1983).

[77] The pleadings and order with respect to Dr. Cormick's motion to quash are included in American Bar Association Special Committee on Dispute Resolution, Confidentiality in Mediation: A Practitioner's Guide, 245 (1985).

[78] Adler v. Adams, No. 673-73C2 (W.D. Wash. 1979).

Freedom of Information Act. If the mediator is either a government employee or a contractor of the Federal government, the effects of the Freedom of Information Act must also be considered: Are either the documents received during the negotiations or the mediator's notes prepared in conjunction with the negotiations agency "records" that would have to be produced in response to an FOIA request?

No Exemption for Settlements. Although public policy clearly favors the voluntary settlement of lawsuits, that policy has not been explicitly incorporated into any of the exemptions to the Freedom of Information Act. As the Department of Justice recently noted:

> There exists strong policy grounds for maintaining the confidentiality of the information exchanged during the settlement negotiation process, but this necessary confidentiality has yet to be recognized under the FOIA by the courts.[80]

Indeed, the court in *Center for Auto Safety v. Department of Justice*[81] found that FOIA itself did not include such an exemption, nor could one be read in by analogy to FRE 408.[82]

Interestingly, there is some legislative history to support the contention that negotiations involving a mediator should be protected from disclosure. The House Report that explains Exemption 4 describes it as embracing "negotiation positions or requirements in the case of labor-management mediations."[83] The language was added in response to a request by the National Mediation Board for express protection of labor-management mediation sessions.[84] A court noted that given the confused and tortured history of FOIA, one House's version "must be accorded great weight, absent compelling contraindications."[85] For whatever reason, the splinter of history has never broadened into a more generally applicable exemption, however.

Whether or not there is a general exemption to FOIA to protect the confidentiality of settlement material akin to FRE 408, much of the data provided the mediator during negotiations will be "trade secrets and commercial or financial information obtained from a person and privileged or confidential" and hence squarely within Exemption 4. Thus, if a private party were to furnish a mediator with documents containing such information, the mediator could resist an FOIA request on grounds of Exemption 4.[86]

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[79] Order on Application for Review of Magistrate's Ruling, Adler v. Adams, No. 673-73C (W.D. Wash. 1979).

[80] U.S. Department of Justice, Office of Information Policy, FOIA Update: Protecting Settlement Negotiations (1965), published at ACUS, Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution 883 (1987).

[81] 576 F.Supp. 739, 749 (D.D.C. 1983).

[82] Accord, NAACP Legal Defense & Educational Fund v. Department of Justice, 612 F.Supp. 1143, 1146 (D.D.C. 1985).

[83] H.Rep. No. 1497, 89th Cong. 2d Sess. 10, reprinted in 1966 U.S. Code Cong. & Admin. News, 2418, 2427.

[84] American Airlines, Inc. v. National Mediation Board, 588 F.2d 863, 869 (2d Cir. 1978).

[85] Id. at 870.

[86] See, e.g., M/A-Com Information Systems v. HHS, 656 F.Supp. 691 (D.D.C. 1986) in which an FOIA request was made for settlement documents developed and exchanged by counsel for HHS and counsel for a company in an unsuccessful effort to settle a debarment action. The documents that were sought described accounting and other actions the company was willing to implement as a condition of avoiding debarment. The court held the documents were exempt from disclosure by Exemption 4.

In addition, the Department of Justice takes the position that Exemption 5 should also provide the basis for protecting documents generated in settlement negotiations from FOIA.[87] There are two strands to the argument that Exemption 5 would protect these materials. The first is that whether the materials originate inside the agency itself or are submitted by other parties in an effort to settle litigation with the government, they are used by the government to make decisions -- the decision as to whether or not to settle the litigation and, if so, on what terms. Thus, the argument runs, settlement materials fall within the "predecisional" exemption to FOIA. The other strand is closely related to the applicability of Exemption 4 in that it builds on the emerging case law[88] that FRE 408 protects settlement documents from discovery absent a showing of need. This "privilege" would necessarily mean that the "intra-agency" material "would not be available by law to a party ... in litigation with the agency."[89] Thus far, however, the latter argument has not met with favor. Several courts have held that documents exchanged with others are not "intra-agency" memoranda.[90] The Department of Justice believes these cases are excessively narrow and, in light of the privilege resulting from Rule 408, will result in an adversary with the government's being able to obtain more in FOIA than in discovery.[91] The Department notes that the Supreme Court has already condemned such an anomaly.[92] Thus, DOJ is likely to continue to press the point that Exemption 5 protects documents developed for settlement purposes.[93]

Whatever else, workproduct is clearly protected from disclosure under Exemption 5.[94]

Agency Records. Only agency records are subject to the Freedom of Information Act.[95] Thus, if a document is not an agency record, an agency is not obligated under FOIA to disclose it.

Although the exact terms vary, a standard clause in many government contracts -- entitled "Rights in Data" -- provides that all material or data generated, produced, or collected pursuant to the performance of tasks under the contract are the property of the contracting agency.[96] Such a clause in a contract between an agency and a mediator would mean that the documents provided the mediator in confidence by any party to or participant in the negotiations and the mediator's notes would be agency records subject to FOIA: the mediator's notes would be produced and the documents would be "collected" pursuant to tasks under the contract. In that case, unless covered by an exemption, virtually all of the material developed by the mediator could be subject to mandatory disclosure. That would surely be a chilling prospect with respect to realizing any notion of confidentiality.

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[87] FOIA Update, supra note 80.

[88] See discussion at p. 11 supra.

[89] 5 U.S.C. § 552(b)(5). The Supreme Court has said "[t]he test under Exemption 5 is whether the documents would be 'routinely' or 'normally' disclosed" in civil discovery. FTC v. Grolier, Inc., 462 U.S. 19, 26 (1983).

[90] County of Madison v. Department of Justice, 641 F.2d 1036, 1040-1042 (1st Cir. 1981); Norwood v. FAA, 994, 1002-3 (W.D. Tenn. 1984); M/A-Com Information Systems, Inc. v. HHS, 656 F. Supp. 691, 692 (D.D.C. 1986).

[91] DOJ, supra note 80.

[92] United States v. Weber Aircraft Corp., 465 U.S. 792 (1984).

[93] Even if this effort is ultimately successful, the protection accorded settlement documents under FOIA would be less than that afforded by Rule 408 unless the courts read the rule into FOIA totally. Customarily an agency would be required under FOIA to disclose essentially factual material. Mead Data Central, Inc. v. Dept. of the Air Force, 566 F.2d 242 (D.C. Cir 1977). Once the agency has made a decision, the documents embodying it must then be released. Taxation with Representation Fund v. IRS, 646 F.2d 666 (D.C. Cir. 1981).

To be sure, this law evolved from the general "governmental privilege" that protected the internal deliberative process, and consequentially the same requirements may not apply if the courts find a privilege in Rule 408 and incorporate it in Exemption 5: in that case the requirements should be coterminous.

[94] FTC v. Grolier, Inc., 462 U.S. 19 (1983).

[95] 5 U.S.C. § 552(a)(3).

[96] See, Federal Acquisition Regulation Regarding Patents, Data, and Copyrights, Subpart 27.4 -- Rights in Data and Copyrights, 52 Fed. Reg. 18140 (1987).

To meet that concern, two agencies have agreed in contracts for mediation services that the government will not claim rights to "mediators' notes, recollections, or documents given to mediators in confidence by any party."[97] This clause recognizes that the government is purchasing the professional services of a mediator and not, as the model clauses are aimed at, information or products. Thus, to ensure a broader scope of protection of confidential material, agencies could include similar provisions. For these purposes, it would be better if the protection ran to all materials provided in confidence pursuant to a mediation, and not just those furnished by a party.

Even if a form of the standard clause is included in a contract between the government and the mediator, the mediation material may nevertheless be relatively safe from having to be turned over in response to an FOIA request. The agency may have a *right* to the data, but if -- as is virtually always the case -- it does not take possession of it, the material is not an agency record subject to the act.[98] In short, the agency is not required to round it up and turn it over in response to a request.[99] Although not as secure as a contract provision that explicitly provides that the mediation material is not an agency record, the practical effects of FOIA would have the same result.

The mediator's notes are potentially free from disclosure under FOIA whether the mediator is an independent contractor or an agency employee, although to be sure the matter is not free of doubt.

The Supreme Court defined the criteria to be used in deciding when materials are agency records when deciding whether notes of telephone conversations that Henry Kissinger made while National Security Advisor must be released under FOIA. The notes were not subject to FOIA when they were made inasmuch as Dr. Kissinger was then part of the Executive Office of the President which is not covered by the Act. They were subsequently transferred, however, to the State Department when he became Secretary of State. Thus, the notes were physically present in the Department which is covered by FOIA. The notes were not generated in the Department, were not used by the Department itself for any purpose, and never entered the Department's filing system. The Court found that four factors are instrumental in determining whether material that is physically present in an agency are "agency records" subject to FOIA: whether the documents were (1) in the agency's control; (2) generated within the agency; (3) placed into the agency's files; and, (4) used by the agency for any purpose.[100] The Court held that the notes were not agency records.

Subsequent cases elaborated on the status of documents that were generated outside the agency,[101] but which were in the agency's physical possession. They held that under this standard, mere possession is not enough: There must be "some 'nexus' between the agency and the documents other than the mere incidence of location."[102] Thus, even if an agency were to obtain materials from a mediator, so long as they remained segregated from the agency's own files and the agency did not use them for any purpose, they would not be "agency records" subject to FOIA.

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[97] Council on Environmental Quality, Contract No. EQ6C03 (July 17, 1986); Environmental Protection Agency, Contract No. 68-01-7388 (1987).

[98] Forsham v. Harris, 445 U.S. 169 (1980).

[99] Kissinger v. Reporters Committee for Freedom of the Press, 445 U.S. 136 (1980).

[100] Kissinger v. Reporters Committee for Freedom of the Press, 445 U.S. 136, 157 (1980).

[101] If documents are generated in one agency and would be within the reach of FOIA but for the fact they were transferred to another agency, they retain their status as an "agency record" regardless of whether the second agency "used" them. McGehee v. CIA, 697 F.2d 1095, 1109 (D.C. Cir. 1983).

The more difficult question is the status of a mediator's notes and the attendant settlement materials if the mediator is a government employee. Several cases have considered the applicability of FOIA to a government employee's notes that were written by an employee during working hours.[103] As with documents originating outside the agency, the test turns on whether the agency has control and the use to which they are put.[104] In *Bureau of National Affairs v. DOJ*,[105] the requestors sought the appointment calendars, telephone logs, and daily agendas of the Assistant Attorney General for Antitrust. The court reasoned

> [A]t least in some circumstances, the agency's use of a document is relevant for determining its status as an "agency record." Where, as here, a document is created by an agency employee, consideration of whether and to what extent that employee used the document to conduct agency business is highly relevant for determining whether that document is an "agency record" within the meaning of FOIA. Use alone, however, is not dispositive; the other factors mentioned in *Kissinger* must also be considered: whether the document is in the agency's control, was generated within the agency, and has been placed into the agency's files.

And, even if they are physically in the agency's file cabinets,

> the statute cannot be extended to sweep into FOIA's reach personal papers that may "relate to" an employee's work -- such as a personal diary containing an individual's private reflections on his or her work -- but which the individual does not rely upon to perform his or her duties.

The court held that telephone slips and appointment calendars were for the personal convenience of the official and were not used in facilitating agency business. But, the agendas were prepared to inform the staff of the AAG's schedule and they were distributed to the staff for its use. The court held that these were not created for the personal convenience of the AAG but for the staff in the conduct of official business.

If, and it is a big if, the mediator's personal notes are regarded as facilitating his or her work in mediating the dispute as opposed to being used by the agency in pursuit of *its* program, the notes would not be regarded as agency records under FOIA. Under the circumstances, however, it is hard to predict whether a court would agree that the notes are solely for the personal convenience of the agency mediator as opposed to something the individual relies upon to perform official duties. The analysis would be bolstered if the agency mediator were to segregate the files, so they are not seen by any other agency employee, and take precautions that mediation data not be commingled with other agency materials. It could then be argued that the agency does not actually have control. But, the argument seems attenuated, and the risk that they will be regarded as agency records is accordingly high.

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[102] Wolfe v. HHS, 711 F.2d 1077, 1080 (D.C. Cir. 1983) (Presidential transition documents not agency records).

[103] Two courts have held that handwritten notes recounting impressions of meetings and substantive discussions are not agency records. British Airports Authority v. CAB, 531 F.Supp 408 (D.D.C. 1982); Porter County Chapter of the Izaak Walton League of America v. AEC, 380 F.Supp. 630 (N.D. Ind. 1974). The reasoning of these cases was expressly disapproved by the District of Columbia Circuit in Bureau of National Affairs v. DOJ, 742 F.2d 1484 (D.C. Cir. 1984).

[104] Bureau of National Affairs v. U.S. Department of Justice, 742 F.2d 1484 (D.C. Cir. 1984).

[105] 742 F.2d 1484 (D.C. Cir. 1984).

In sum, the materials developed by a mediator under contract to a government agency will likely not be subject to an FOIA request because the agency will not have taken control of them and hence they are not agency records. But the agency *could* take possession under the standard contract clause, and some of the parties may fear revelation to the agency most of all. Thus, the agency should include a clause in the contract that explicitly protects this material.

If, on the other hand, the mediator is an agency employee the question becomes whether the agency itself has sufficient control over the materials, including the mediator's notes, and whether the materials are used "by the agency 'for any purpose.'" If, as seems likely, part of the employee's job is the mediation of disputes, it would seem that the mediation materials are indeed agency records subject to FOIA. Hence they would be subject to disclosure unless -- as will often be the case -- they are protected under one of the exemptions.[106]

Mediation Privilege

Because of the uncertain legal environment with respect to protecting the confidentiality of mediation materials and the perceived benefit to be derived from it, many practitioners and writers have urged the establishment of at least some sort of privilege for mediation materials.[107]

There is, however, a contrary argument against a broad privilege.[108] Bearing particularly on negotiations having public policy implications is the belief that mediation behind closed doors may undermine the public's confidence in the resulting agreement. The opponents of such a privilege also point out that mediation succeeds in some programs without an elaborate confidentiality scheme. Indeed, they argue, virtually all of the complex mediation conducted thus far is subject to the vagaries of the law described above and has been relatively successful without a more elaborate scheme of protection for the confidentiality of mediation.

In addition to this argument against a privilege that would protect the confidentiality of mediation generally, some feel that the mediator should be able to release proposed settlements as a means of putting pressure on the parties to settle. They argue that a party who fails to bargain in good faith should be held accountable for doing so by means of public disclosure. In their view, if someone accepts a proposal at the table but subsequently repudiates the deal, the mediator should be able to reveal that the person had indeed agreed to the provision, either by means of a public announcement on television or a press release.[109] The mediator in this situation can use the potential of disclosure as a threat to the parties to adhere to the deals made at the table; they believe that will help hold the participants in public negotiations accountable for what is said and done in the discussions.[110]

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[106] For example, notes the agency mediator exchanges with his or her immediate staff or superiors for purposes of helping in the negotiation would be covered by Exemption 5; routine factual reports, however, likely would not.

[107] See, e.g. Restivo and Mangus, supra note 52, at 9:

> Strong arguments can and should be made to protect the confidentiality of [ADR] proceedings. Under statutory and public policy grounds such proceedings should not be admissible. Under public policy grounds or a "privilege" analysis, such proceedings should not even be discoverable. Under public policy and statutory grounds, the third-party neutral should be immune from subpoenas.

See also, Freedman and Prigoff, supra note 61; Rogers and Salem, supra note 32.

Eric Green begins his analysis of mediation privilege this way: "Conventional wisdom among practicing mediators is that the confidentiality of mediation should be protected by a statutory or court-created privilege." Green, supra note 47, at 1.

[108] Arguments against a broad privilege are summarised in Rogers and Salem, supra note 32 at 67-71.

[109] See, Bacow and Wheeler, Environmental Dispute Resolution, 246-7 (1984).

Professor Eric Green believes the proponents of a mediation privilege have simply not made their case sufficiently:

> [T]he current campaign to obtain a blanket mediation privilege rests on faulty logic, inadequate data, and short-sighted professional self-interest. Neither the necessity for such a privilege nor the social utility of a general mediation privilege have been demonstrated. Moreover, an adequate degree of confidentiality in mediation can be obtained with only slight changes in current laws.[111]

In his view, if there is to be a privilege, it should belong to the parties and not the mediator:[112] It would seem to follow that if all the parties to the negotiation request the mediator to reveal their discussions, he or she should do so.[113] But, Green continues,

> mediation, over the long run, may require that the mediation be separated from and protected against adjudication, so that even if all the parties to mediation are willing to dispense with the confidentiality and inadmissibility of mediation, the law would not permit information from the mediation to be used in court. Recognition of a privilege in this situation is based on an institutional concern for mediation as an important and distinct resolution process, rather than a concern for the mediators' own professional interests.[114]

He contends that the current law can be supplemented by a carefully tailored confidentiality agreement among the parties that will afford adequate and well tailored protection to the confidentiality of mediation.

The main thrust of Green's dissent is that a blanket privilege will result in little gain and yet incur public distrust that agreements negotiated in secret may produce unfair results.[115] By and large, therefore, he counsels a carefully crafted protection that provides the requisite protection without the overbreadth that generally results from statutory provisions or court rules. For example, he suggests that since "the mediator's notes, impressions, and opinion may be among the most tempting items of evidence," the mediation agreement should explicitly tie them to the settlement process in an effort to tuck them under FRE 408.[116]

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[110] Of course, a contrary way of looking at this situation is that the representative at the table made what he or she thought was a satisfactory tentative agreement only to discover that it did not fly with the constituents. The representative then had to modify his or her position accordingly. This contrarian view would then argue that the ability to change position in response to the desires of the constituents is a better means of preserving accountability -- leadership it is not, but it is accountability. The confidential nature of the negotiations would then enable the participants to work out a package that might be difficult in a public meeting, and the package can then be taken as a whole to the folks back home.

[111] Green, supra note 47, at 2.

[112] Id. at 4.

[113] The American Bar Association's Standing Committee on Dispute Resolution drafted a proposed rule on the confidentiality of mediation. It provided that if all the parties authorised the mediator to release documents developed in the negotiations or to testify concerning them, he or she should be required to do so. This provision was quite controversial in the Committee's deliberations. The Committee has not yet acted on completing the draft rule which is in the form of a resolution to be considered by the House of Delegates of the ABA as the Association's policy; the proposal has no other formal status.

[114] Id. at 5.

[115] Id. at 11.

[116] Id. at 19-20.

Because of the uncertain status of the confidentiality of mediation materials under current law, the many holes in the protection regardless of its strength in other areas, and the premium on careful lawyering that is entailed in relying on detailed confidentiality agreements, many mediators rely on an "ad hoc" privilege: They return all documents provided them by others during the negotiations and destroy their own notes; they may be compelled to testify, but they will be unable to provide any written material. To foster the resolution of disputes by mediated negotiations by providing a more comprehensive and systematic basis for the confidentiality of the negotiations, many statutes, rules, and guidelines have explicitly provided for some degree of confidentiality of mediation materials.

Examples of Standards Governing Mediator Confidentiality

Statutes and Regulations. The Federal Mediation and Conciliation Service regulations provide:

> Public policy and the successful effectuation of the Federal Mediation and Conciliation Service's mission require that commissioners and employees maintain a reputation for impartiality and integrity. Labor and management or other interested parties participating in mediation efforts must have the assurance and confidence that information disclosed to commissioners and other employees of the Service will not subsequently be divulged, voluntarily or because of compulsion, unless authorized by the Director of the Service.
>
> No officer, employee, or other person officially connected in any capacity with the Service, currently or formerly shall, in response to a subpoena, subpoena duces tecum, or other judicial or administrative order, produce any material contained in the files of the service, disclose any information acquired as part of the performance of his official duties or because of his official status, or testify on behalf of any party to any matter pending in any judicial, arbitral or administrative proceeding, without the prior approval of the Director.[117]

The statute creating the Community Relations Service of the Department of Justice, which mediates community disputes relating to discriminatory practices, provides:

> The activities of all officers and employees of the Service in providing conciliation assistance shall be conducted in confidence and without publicity, and the Service shall hold confidential any information acquired in the regular performance of its duties upon the understanding that it would be so held.[118]

Similarly, the regulation governing the mediation of age discrimination disputes provides:

> The mediator shall protect the confidentiality of all information obtained in the course of the mediation process. No mediator shall testify in an adjudicative proceeding, produce any document, or otherwise disclose any information obtained in the course of the mediation process without prior approval of the head of the agency appointing the mediator.[119]

Those governing conciliation efforts of the Equal Employment Opportunity Commission are:

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[117] 29 C.F.R. § 1401.2.

[118] § 1003(b), PL 88-352, 78 Stat 267.

[119] 45 CFR § 90.43.44.

> (a) Nothing that is said or done during and as part of the informal endeavors of the Commission to eliminate unlawful employment practices by informal methods of conference, conciliation, and persuasion may be made a matter of public information by the Commission, its officers or employees, or used as evidence in a subsequent proceeding without the written consent of the persons concerned....
>
> (b) Factual information obtained by the Commission during such informal endeavors, if such information is otherwise obtainable by the Commission under section 709 of Title VII, for disclosure purposes will be considered by the Commission as obtained during the investigatory process.[120]

Congress very recently passed a statutory requirement that is more limited in scope. It provides that the Office Administrative Law Judges in the Department of Education

> shall establish a process for the voluntary mediation of disputes pending before the Office. ... In accordance with rule 408 of the Federal Rules of Evidence, evidence of conduct or statements made in compromise negotiations shall not be admissible in proceedings before the Office.[121]

Administrative Guidelines. The Department of Justice issued a policy statement concerning the use of mini-trials for resolving disputes between the Department and private parties. The guidelines provide that

> all oral presentations made, and all discussions between or among the parties and/or the advisor at the mini-trial are confidential to all persons, and are inadmissible as evidence, whether or not for purposes of impeachment, in any pending or future court or board action which directly or indirectly involves the parties and the matter in dispute. However, if settlement is reached as a result of the mini-trial, any and all information prepared for, and presented at the proceedings may be used to justify and document the subsequent agreement.[122]

More generally, the Society of Professionals in Dispute Resolution recently adopted a Code of Ethical Standards of Professional Responsibility that provides in pertinent part:

> Maintaining confidentiality is critical to the dispute resolution process. Confidentiality encourages candor, a full exploration of the issues, and a neutral's acceptability. There may be instances, however, in which confidentiality is not protected. In such cases, the neutral must advise the parties, when appropriate in the dispute resolution process, that the confidentiality of the proceedings cannot necessarily be maintained. Except in such instances, the neutral must resist all attempts to cause him or her to reveal any information outside the process. A commitment by the neutral to hold information in confidence within the process must also be honored.[123]

As a final example of guidelines or rules applicable to mediation, the Commercial Mediation Rules of the American Arbitration Association provide:

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[120] 29 CFR § 1601.26

See, *International Ass'n of Machinists v. National Mediation Board*, 425 F.2d 527 (D.C. Cir. 1970); *Burlington Northern, Inc. v. EEOC*, 582 F.2d 1097 (7th Cir.) *cert. den.* 440 U.S. 930 (1978).

[121] § 451(h) of the General Education Provisions Act, as amended by § 3501 (a) of PL 100-297. For a discussion of Rule 408 of the Federal Rules of Evidence, see infra at note 48.

[122] ACUS, *Sourcebook: Federal Agency Use of Alternative Means of Dispute Resolution* 827, 839 (1987). The relevant guidelines of the Corps of Engineers with respect to mini-trials is identical. Id. at 703, 719.

[123] Society of Professionals in Dispute Resolution, *Ethical Standards of Professional Responsibility*, Paragraph 3 (1986).

> Confidential information disclosed to a mediator by the parties or by witnesses in the course of the mediation shall not be divulged by the mediator. All records, reports, or other documents received by a mediator while serving in that capacity shall be confidential. The mediator shall not be compelled to divulge such records or to testify in regard to the mediation in any adversary proceeding or judicial forum.[124]

State Legislation. At least ten states have recently enacted legislation to protect the confidentiality of mediation.[125] Not surprisingly, they vary widely in scope and style. The Massachusetts Confidentiality in Mediation provision, for example, provides:

> All memoranda, and other work product prepared by a mediator and a mediator's case files shall be confidential and not subject to disclosure in any judicial or administrative proceeding involving any of the parties to any mediation to which such materials apply. Any communication made in the course of and relating to the subject matter of any mediation and which is made in the presence of such mediator by any participant, mediator or other person shall be a confidential communication and not subject to disclosure in any judicial or administrative proceeding; provided, however, that the provisions of this section shall not apply to the mediation of labor disputes.[126]

The recent Virginia enactment is fairly typical:

> All memoranda, workproducts and other materials contained in the case files of a mediator or mediation program are confidential. Any communication made in or in connection with the mediation which relates to the controversy being mediated, whether made to the mediator or a party, or to any other person if made at a mediation session is confidential. However, a mediated agreement shall not be confidential unless the parties otherwise agree in writing.
>
> Confidential materials and communications are not subject to disclosure in any judicial or administrative proceeding except
>
> (i) where all parties to the mediation agree, in writing, to waive the confidentiality,
>
> (ii) in a subsequent action between the mediator and a party to the mediation for damages arising out of the mediation, or
>
> (iii) statements, memoranda, materials and other tangible evidence, otherwise subject to discovery, which were not prepared specifically for use in and actually used in the mediation.[127]

Abstract of the Various Requirements. Each of these standards provides for some degree of confidentiality with respect to communications with a mediator and of the mediator's notes or other workproduct. Each of them direct the mediator to maintain confidentiality. Many of them do not specifically authorize the parties to the negotiation to waive any resulting privilege and direct the mediator to testify in a subsequent proceeding or otherwise reveal portions of the discussions.[128] Some, however, permit the parties to do so.[129] Some of the standards enable someone in a higher position than the mediator to authorize the mediator to divulge the information -- that is, they provide an override to the general rule.[130] Some explicitly direct that the material may not be used in an adjudicatory proceeding.[131]

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[124] American Arbitration Association, *Commercial Mediation Rules*, Rule 12 (1987).

[125] See, Standing Committee on Dispute Resolution, American Bar Association, *State Legislation on Dispute Resolution* (1988).

[126] § 23C, added by St. 1985, c. 335.

[127] Virginia Code § 8.01-581.22.

A few implicitly direct the mediator to resist a subpoena or other order for the information.[132] EEOC's regulations[133] provide that factual information learned during a conciliation effort will be treated as part of an investigatory file if it would be obtainable by the Commission under other regulatory requirements; Virginia[134] and presumably the new Education Act[135] recognize that material that would otherwise be discoverable does not become immune simply because it crossed the negotiating table. The Department of Justice's mini-trial guidelines[136] establish a blanket confidentiality during the negotiations, but at the conclusion of a successful mini-trial, they authorize the use of everything to document the agreement. In Massachusetts, the mediator's notes, workproduct and case file are immune from inquisition but only in proceedings involving at least one of the parties to the negotiation; otherwise, it appears that the materials are not protected. Virginia[137] alone among the standards, authorizes the release of the otherwise confidential material "in a subsequent action between the mediator and a party to the mediation for damages arising out of the mediation." The SPIDR Ethical Standards[138] recognize that there will be situations in which a mediator is required by law to disclose something that was learned in otherwise confidential negotiations. In that case, the mediator is directed to inform the parties that confidentiality cannot in all instances be maintained; customarily, if the mediator is aware of specific requirements, he or she informs the parties to the negotiation of the types of information that will have to be revealed.

Thus, there is no one, single approach to mediator confidentiality. To stimulate administrative settlements while taking account of other essential attributes of resolving public disputes, a carefully crafted rule is needed that draws on this experience.

Proposed Approach

Negotiations over issues involving the statutes, regulations, and policies of administrative agencies necessarily have important public attributes. Maintaining rigorous confidentiality of all aspects of the negotiations would unquestionably facilitate the parties' reaching agreement. But equally unquestionably, decisions affecting the public welfare that are made in the open and are subject to scrutiny have a far greater political acceptance. Since settlements are essential to administrative agencies, a careful balance must be struck between the openness that is critical for the legitimacy of the agreements reached and the confidentiality that is critical if agreements are to be reached. The proposal below attempts to strike that balance.[139]

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[128] FMCS, supra p. 22; CRS, supra p. 22, age discrimination, supra p. 22, DOJ's mini-trial guidelines, supra p. 23, except, however, these guidelines are to be incorporated into a contract among the participating parties and hence it would be likely that they could modify their own agreement subsequently should they so desire; SPIDR, supra p. 23, AAA, supra p. 23, Massachusetts, supra p. 24.

[129] EEOC, supra p. 22; inasmuch as the new Education Act incorporates the standards of Rule 408, it would, see supra p. 23; Virginia, supra p. 24

[130] FMCS, supra p. 22; age discrimination, supra p. 22.

[131] Age discrimination, supra p. 22, EEOC, supra p. 22, Education, supra p. 23; Massachusetts, supra p. 24.

[132] FMCS, supra p. 22, CRS, supra p. 22, age discrimination, supra p. 22; EEOC, supra p. 22; SPIDR, supra p. 23; AAA, supra p. 23, Massachusetts, supra p. 24.

[133] Supra p. 22.

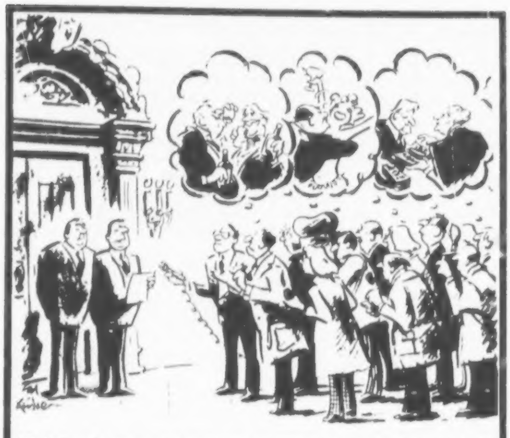
[134] Supra p. 24.

[135] Supra p. 23.

[136] Supra p. 23.

[137] Supra, p. 24.

[138] Supra p. 23.



"To facilitate the negotiations, all participants have agreed to refrain absolutely from any further disclosure of what may be taking place on the other side of the conference-room door."

Drawing by Ed Fisher; © 1962
The New Yorker Magazine, Inc

THE DILEMMA

The fundamental premise of the proposed approach is that for certain types of cases a mediator can significantly help the parties reach a responsible agreement. To encourage the use of a mediator in these negotiations, the rule protects the communications between the mediator and the parties or other participants in the course of the negotiations as well as the mediator's own notes and impressions. Importantly, the proposed approach is limited solely to protecting these communications, and it provides a series of limited, narrow exceptions to deal with extraordinary circumstances. The proposed rule does not address when meetings or other aspects of negotiations should be held in public; that is a matter for other law and political considerations. Nor does it address directly the extent to which the *parties* or other participants can or should be able to preserve the confidentiality of their negotiations. Thus, the extent to which the parties are free to disclose what went on or be compelled to do so is independent of this rule. Also, the rule does not address the extent to which any agreement that is reached will have to be documented by materials that are developed or otherwise produced in the course of the negotiations. Surely many of the agreements reached pursuant to a settlement proceeding involve significant issues of public policy, and their factual and policy basis will have to be explained. This rule has no bearing on the extent to which materials used in the negotiations can and should be incorporated into that document or disclosed in response to an investigation by an Inspector General or other body.

The mediator will virtually *never* have information or evidence that is not shared by at least one other person, excepting of course the mediator's own notes, recollections, and judgments. All the documents and statements of the parties to each other would exist but for the mediator. Thus, shielding the mediator from being the source of information about the negotiations does not restrict the availability of evidence beyond that which would exist if the mediator did not serve. As to the material the neutral has in common with others, it would be inconsistent with stimulating settlements to convert the mediator into a cop or collection agent. Thus, that information should be obtained from the others: the mediator should be the source of information only as a last resort.

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[139] For an outstanding discussion of the issues involved in developing a general rule for mediation privilege, see Hyman, Model Confidentiality Rule: A Commentary, 13 Seton Hall Leg. J. ____ (Forthcoming 1988).

The only *new* evidence that exists because of the presence of the mediator is the mediator's own notes and impressions. Of course, some litigants might want the mediator to testify about the negotiations precisely because it would provide a neutral appraisal of the events. But, the role of mediator is antithetical to that of judge or arbitrator, and forcing the mediator to reveal his or her judgments about the events would greatly harm the ability of the neutral to function as a mediator. While having some "independent" view of what went on may be helpful to resolve a conflict in testimony between those who were also there, adjudicatory proceedings are designed to do just that, and the value in achieving settlements has been held to outweigh whatever benefit there may be to the trial process.[140] It seems doubtful that a subsequent litigant would subpoena a judge who brokered a settlement in chambers; the same theories would seem to apply.[141]

The mediator's notes[142] and mental impressions should be held rigorously confidential to preserve the integrity of the settlement process and for the same reasons that underlie the workproduct doctrine. Forcing their revelation would virtually destroy the benefits of the process and would, except in extremely rare cases, yield little that cannot be gained from the parties themselves.

There may be other instances when a public policy in an individual case favoring disclosure is of sufficient magnitude to override the diminution in the confidence future parties will have that their communications will remain confidential: the specific need should be extraordinarily strong to override the general benefit of confidentiality. For example, someone may make a preliminary showing that the negotiations resulted in an antitrust offense or a major contract fraud. Some initial demonstration of a significant offense should be required before breaching the confidentiality; if a mere allegation or any minor infraction could penetrate the assumption of confidentiality, the general rule would become worthless -- any lawyer could concoct such a complaint. Similarly, if an issue was revealed during negotiations that would significantly affect the public health or safety, the material should be revealed so suitable precautions can be taken. The point is not any specific set of facts or law, but rather that the veil should be pulled back only for truly exceptional cases of substantial magnitude.

Applicability. The purpose of the model rule is to protect the integrity of confidential communications with the mediator and the mediation process itself. Since its purpose is to facilitate settlements of issues directly relevant to an agency program, and not just those in which the agency is a particpant, the rule should apply to a group of private parties that are seeking to resolve an among themselves. It is in the agency's interest to facilitate that process, and the rule would do so. Moreover, if the issues in controversy can be resolved before formal proceedings are instigated, both the private parties and the agency can save valuable resources The rule therefore applies to *all* negotiations over issues of concern to the agency, whether or not the agency itself is a party and whether or not a formal proceeding has been initiated.

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[140] NLRB v. Joseph Macaluso, Inc., 618 F.2d 51 (9th Cir. 1980).

[141] There are, of course, important differences: The judge can be held directly accountable for his or her actions by public authorities, whereas a mediator is not licensed nor holds public office and hence is not as directly accountable to the public. In addition, the judge has disciplinary powers that could be wielded to parties that were less than forthright in the negotiations. As one experienced practitioner puts it, a mediator has all the power of a volunteer directing traffic around an accident. But that emphasises the earlier point: the power in the negotiations belongs to the parties alone, and hence it should be they who provide the evidence. The mediator merely aids in the discussions.

[142] These notes include not only those taken by the mediator alone, but also those of his or her staff and to his or her superior for purposes of conducting the negotiations: it is the nature of the material that is confidential, not just who prepared it.

The protection of the rule would start whenever someone begins serving as a neutral[143] and the parties deal with that person in such a way as to indicate a reasonable belief that their communications will be held confidential. It would be best, of course, if the parties formally indicated that their negotiations were subject to the rule. Doing so would remove any doubt as to their intentions. But, requiring the parties to make the acknowledgement would place a premium on knowing the details of the Code of Federal Regulations and careful lawyering. The provisions of the rule should apply to the innocent as well as the sophisticated.

On the other hand, it does not seem appropriate to attempt to impose the terms of the rule on all the parties for all issues. If they prefer a different set of protections -- or, indeed, none at all -- they should be free to vary the terms by entering into a confidentiality agreement that is specific for their negotiations. In that case, the rule provides that the specific agreement will govern to the extent authorized by law. If some aspect of that agreement is held to be unenforceable, the agreement should nevertheless be upheld to the extent consistent with the rule.

To be sure, it is appropriate for the parties to be able to modify the confidentiality rule applicable to their negotiations. But, the rules of the game are likely to be very important to the mediator, so it would *not* be appropriate for the parties to be able to change those rules in the middle of or even after the game has been played. Therefore, if the parties wish to modify the "default" rule, they should do so before beginning their mediated negotiations and inform the neutral of their desires. In that way, the neutral can decide whether or not he wishes to serve under those groundrules; if so, he can adapt his behavior accordingly.

What is Covered. A "settlement proceeding" is defined as any process that is designed to resolve matters involving a statute, regulation, or policy of the agency (defined as "issues in controversy") by agreement of the parties and in which a neutral serves.

The rule covers oral communications or actions that are related to a settlement proceeding. It also applies to documents that are created specifically for the negotiations or other, previously existing documents that are furnished to the mediator in confidence by a participant in the negotiation.[144] A party need not designate a communication or document as confidential for the rule to apply; it is sufficient if the circumstances are such that they create a reasonable expectation that the information will be held confidential.[145] The presumption would be that non-public meetings of the parties and the mediator would be confidential.

Since the rule is designed to foster candor and confidence in proceeding through direct negotiations, and to make it "safe" to explore a variety of potential solutions to the controversy, it applies to both the parties and to others who participate in the negotiation process.

The General Rule: Neutral Shall Not Disclose or Testify Concerning Settlements. The rule provides that the neutral may not voluntarily reveal confidential information from the negotiations. Moreover, the neutral is protected from having to disclose the information in response to a discovery request or a subpoena.

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[143] This may be when a party has asked the person to explore the potential for resolving the issues in controversy through negotiation or to serve as the neutral in such a proceeding; the idea for such an effort may originate elsewhere, in which case at least one of the parties would need to accept the person as a neutral for these purposes.

[144] Although previously existing material may be provided to the mediator and other parties in confidence for purposes of the negotiation, as in Rule 408, it would not be immune from discovery if it would otherwise be discoverable. The rule would provide, however, that it would not be discoverable from the mediator, only from the originating party or participant.

[145] That the parties had no reasonable expectation of confidentiality was instrumental to the court in deciding to require a mediator to testify concerning the negotiations in Drukker Communications, Inc. v. NLRB, 700 F.2d 727 (D.C. Cir. 1983).

One of the major shortcomings of Rule 408 on its face is that it would permit the discovery, if not the admissibility, of settlement materials. That revelation alone can be significantly inhibiting since that alone could mean the parties to the negotiation could be disadvantaged by things that were said or done in the negotiations. For example, a party to the negotiations may make a proposal that indicates it could "live with" a particular approach that is not ultimately accepted. If that could be discovered, it could be used in other fora to demonstrate that the party would accept this approach; that would force the party to argue as to why the proposal was made and why it was rejected; the end result would be that parties would be understandably reluctant to make proposals and express their views candidly since their revelations could haunt them later. Thus, if the process is to work, the protection must extend to discovery as well as formal admissibility into evidence.

Finally, the restriction against testifying and providing documents would apply regardless of who makes the request and when -- an original party or a person who was not a party; whether or not the issue in the subsequent proceeding is the same or different; no matter whether the request or order is made during the pendency of the original claim or after it has been resolved. Thus, the rule would not permit the ancillary use of mediation materials for such things as impeachment of a witness, because such use would result in the same breach in confidence that can be inhibiting.[146]

Exceptions to the General Prohibition. Unlike some confidentiality requirements, the restrictions on the mediator's disclosing information from the negotiation is not categorically absolute.

Mutual Agreement of Parties and the Mediator. If all of the parties to the negotiation *and* the neutral agree in writing, the neutral can respond to requests; if the information to be revealed came from a non-party participant, that person would also have to agree. Because of the necessity of protecting the integrity of the mediation process as such, it is important that the neutral have a say in whether he or she will disclose aspects of the negotiations. The parties may lack the long-term perspective and also an appreciation of the potential effect on how they will feel about the agreement or the process if the mediator testifies. Thus, the mediator is given a veto power over whether or not to divulge the information sought. It would be expected that the neutral would agree to testify in instances when the question is largely administrative or needed only for a technical reason. If the testimony would go to the substance of the negotiations, the neutral would likely take a far more restrictive position.

Public Documents. If the request is for documents that were exchanged in a public meeting, it seems far easier to have them contact the mediator as a central source than to force someone to canvass everyone who traded papers. The rule would therefore permit the neutral to furnish documents that were submitted in public meetings or are otherwise already in the public domain.

Required by Law. Some materials that are furnished to the mediator will be required by law either to be made public or to be furnished to an agency or other official. Simply because they were used in the negotiations would not override that obligation. But, the mediator should be the source of last resort, and not simply a convenient place to gather in the required materials. Thus, the mediator would be required to provide this type of information, but only if it is not available either from the person or organization that originated it or from any other source. It could be, for example, that a party to a negotiation provided the mediator with a document that is required to be filed with an agency and subsequently destroyed all copies; in that case, the mediator would be obligated to furnish the document. By its nature, this exception should rarely be called into play.

Judicial Override for Extraordinary Cases of Importance. There may be some instances of a vitally important, overriding need to invade the confidentiality of the negotiations. The mediator would be authorized under the rule to respond to a court order that finds the revelation of the material is necessary to prevent a manifest injustice or a violation of law. The court is directed to balance the needs in the case before it against the damage that disclosure may make to the long-run integrity of the process by diminishing the confidence the parties have that their negotiations will remain private. The issue presented should be of significant magnitude and a preliminary showing made that the information sought will indeed provide unique[147] admissible evidence that is necessary to resolve an issue of overriding importance. In addition, the court may order that information be made public to protect the public health or welfare.

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[146] Hyman, supra note 139.

When faced with questions such as these, a court is likely to order the mediator to reveal the material whether or not the rule provides for it. The rule therefore acknowledges what may well occur anyhow, and by doing so it relieves the mediator of the conflict he or she would feel in having to choose whether to honor the rule or the order. In doing so, the rule defines the criteria a court would use in making that decision, so that it would not be too cavalier in intruding into the settlement process.

The mediator alone could, of course, be authorized to make the decision to disclose in situations such as this. But that would place the mediator in an extraordinarily difficult position of conflict, and he or she may lack the resources to determine the accuracy of the claim. In the FMCS regulations,[148] for example, the Director of FMCS is authorized to decide to override the general confidentiality requirement. In this case, however, there is no "higher authority" over the neutral that could make such a decision. It would be inappropriate to have the agency itself make it since the private parties could reasonably fear that the agency would misuse the power to its advantage and hence that the negotiations would not in fact remain confidential. Thus, to protect the integrity of the process, the rule provides that a court should make the determination of overriding public need.

Dispute Involving the Neutral. Finally, a dispute may arise between the mediator and one or more of the parties, such as over-payment or ethics. Since that controversy is likely to surround what went on in the negotiations, the neutral should be free to defend his interest by disclosing otherwise confidential materials. But, the rule provides that that material may be used only for that limited purpose and not for resolving any issue in controversy in the settlement proceeding.

Notice. The rule directs the neutral to take reasonable steps to notify the parties and affected non-party participants of any attempt to compel disclosure of confidential material. In that way, the parties can assist the neutral in protecting their integrity.

Although the rule does not explicitly address the issue, the question will surely arise as to who pays to defend the confidentiality of this information against attack. It would be expected that if a party to the negotiations wishes that the data remain confidential, that party should defray any expenses the mediator incurs in defending his or her ability to maintain the confidence. If, on the other hand, all the parties to the negotiation ask the mediator to disclose the material but the mediator refuses, the costs of defending the challenge will have to be borne by the mediator. They may, of course, be quite significant for a process that is typically relatively low budget.

Agency Records. The agency should include in any contract for the services of a neutral that it is not claiming any right to the neutral's notes, memoranda, workproduct, and materials received by the neutral during the negotiations. In the event the agency fails to provide that sort of insulation, the agency should not seek these materials even if it has a right to them. The materials will then not be agency records subject to FOIA.

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[147] If the evidence is not unique in that it can obtained elsewhere, the confidentiality should be maintained.

[148] See supra page 22.

For an extensive discussion of a similar provision, see Hyman, supra note 139.

If the neutral is a government employee, the issue is more complex. To preserve the integrity of the process, the neutral should carefully segregate the materials so they will be used only by the neutral and no other agency employee. Moreover, they should be used solely for purposes of resolving the issues in controversy in the settlement negotiations. Whether or not they become "agency records" for purposes of FOIA will then depend on the circumstances.

A document that is an agency record independent of the negotiations would, of course, remain such.

Judicial Interpretation. The proposed rule is quite close to the actual implementation of FRE 408 by many courts and the workproduct doctrine. Thus, if courts were to apply the workproduct doctrine to mediators and uniformly apply Rule 408 to prohibit the discovery of settlement data, most of the benefits of this rule could be achieved under existing law at least as to neutrals retained by agencies. To cover neutrals employed by agencies, the courts would, in addition, need to apply the criteria used in determining whether documents prepared by agency employees are "agency records" in such a way as to find that segregated materials that are segregated and used only for settlement purposes by the neutral alone are not within the control of the agency or lack the requisite nexus with the agency's substantive program.

ADMINISTRATIVE CONFERENCE OF
THE UNITED STATES

Report for
STATEMENT 13

THE REPARATIONS PROGRAM AT THE COMMODITY FUTURES TRADING COMMISSION: REDUCING FORMALITY IN AGENCY ADJUDICATION

by

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THE REPARATIONS PROGRAM OF THE COMMODITY FUTURES TRADING COMMISSION: REDUCING FORMALITY IN AGENCY ADJUDICATION

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INTRODUCTION

The Commodity Exchange Act of 1974 (CEA)[1] contains a provision that is unusual, although not unique,[2] in the statutory lexicon of the federal government. Section 14 of the Commodity Exchange Act provides for a civil complaint resolution system, known as the reparations program.[3] In effect, the reparations program is a national civil administrative court for customers of commodities brokers (called futures commission merchants or FCM's), administered centrally from Washington, D.C., by a federal regulatory agency, the Commodity Futures Trading Commission (CFTC). The CFTC reparations program is now receiving increased attention because it is an unusual federal program that is very much in accord with the alternative dispute resolution methods currently the subject of great interest.[4]

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[1] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389-1416 (amending Commodity Exchange Act, ch. 369, § 1, 42 Stat. 998 (1922)).

[2] Some commentators have called the process unique. *See* Markham & Bergin, *Customer Rights Under the Commodity Exchange Act*, 37 VAND. L. REV. 1299, 1345 (1984) (describing CEA provision permitting CFTC to award damages); Graham, *Special Reparations Actions*, 35 BUS. LAW. 773 (1980) (stating CFTC reparations program as unique to federal sector). The unique aspect of the CFTC reparations program is that the CFTC's decision is appealable only to a United States court of appeals, not to a district court for a trial de novo. *See* Graham, *supra*, at 774 (commenting that the Commission is required to conduct a classic APA adjudication since section 14 does not provide for de novo review); *see also* Markham, *The Seventh Amendment and CFTC Reparations Proceedings*, 68 IOWA L. REV. 87, 88, 97-98 (1982) (explaining that legislative history clearly indicates Commission's findings would be reviewable only in courts of appeals with no jury trial or factual review available in district court). Be-

The reasons for the adoption of a reparations program for the CFTC and not for other federal agencies are unclear. The Government Accounting Office (GAO) has asserted that, "in establishing a reparations program, the Congress was attempting to create an expeditious, inexpensive, and easy to use dispute resolution process, available to as many commodity customers as possible."[5] Another explanation for the exis-

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cause the reparations process provides for only limited appellate review of the facts, it has been challenged under the seventh amendment to the United States Constitution as denying a jury trial to the respondent. The challenge, as yet, however, has not been successful. *See* Myron v. Hauser, 673 F.2d 994 (8th Cir. 1982) (holding Congress' creation of statutory scheme without providing for jury trials does not violate seventh amendment); Terson Co. v. Pension Benefit Guaranty Corp., 565 F. Supp. 203 (N.D. Ill. 1982) (dismissing proposition that seventh amendment requires jury trial upon demand in reparation proceedings before CFTC).

[3] Added in 1974, section 14 established the reparations program. The idea of the new program was to complement the informal arbitration programs to be established by the exchanges (section 5a(11)) and futures associations (section 17(b)(10)). Raisler & Geldermann, *The CFTC's New Reparation Rules: In Search of a Fair, Responsive, and Practical Forum for Resolving Commodity-Related Disputes*, 40 BUS. LAW. 537, 539 (1985).

[4] *See, e.g.*, Administrative Conference Recommendation No. 86-3, Agencies' Use of Alternative Means of Dispute Resolution, 1 C.F.R. § 305.86-3 (recommending that agencies adopt and also encourage regulated parties to adopt alternative means of resolving disputes); *A Colloquium on Improving Dispute Resolution: Options for the Federal Government*, 1 ADMIN. L.J. 399 (1987) (describing uses of ADR and addressing problems arising from its use); Friedman, *Alternative Dispute Resolution*, 1 WASH. LAW. 4-5 (1987) (describing an ADR program called "The Multi-Door Dispute Resolution Program" in the District of Columbia); Harter, *Points on a Continuum: Dispute Resolution Procedures and the Administrative Process*, 1 ADMIN. L.J. 141 (1987) (comparing major types of ADR techniques). A comprehensive coverage of dispute resolution techniques can also be found in S. GOLDBERG, E. GREEN & F. SANDER, DISPUTE RESOLUTION (1985).

[5] GAO REPORT, REPARATIONS AND OTHER PRESENTLY AVAILABLE FORUMS FOR THE RESOLUTION OF CUSTOMER CLAIMS, *reprinted in Commodity Futures Trading Commission Oversight: Hearings before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operations*, 97th Cong., 2d Sess. 861 app. 5 (1982) [hereinafter *1982 House Operations Committee Hearings*]. The GAO Report stated that in 1974, "[t]he objectives of the new program [established by Congress] were to provide an alternative grievance procedure, midway in

tence of the program rests more in history than in logic. The 1974 Amendments to the CEA, the statute that created the reparations program, also created the Commodity Futures Trading Commission to administer the program.[6] The CFTC was heir in function to the old Commodity Exchange Authority (Authority), which was part of the United States Department of Agriculture (USDA). The USDA also administered the Packers and Stockyards Act, which has long contained a reparations program.[7] Congress may not, therefore, have intended deliberately to "experiment"[8] with new administrative forms of adjudication, but rather may simply have transposed the essence of the old Packers and Stockyards program onto the new futures regulatory program.[9]

As will be discussed below, whatever might have been the intention of Congress in creating the reparations program within the CFTC, the program has struggled for resources and recognition throughout most of its history. Despite this struggle, the concept of the reparations process as an alternative means of dispute resolution has considerable appeal. In theory, at least, the prototype program offers distinct advantages over both civil judicial actions and industry-sponsored arbitration. It offers a dispute resolution system liberated from the formal, rigidly conventional system of civil litigation.[10] In addition, unlike civil court,

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complexity and expense between the traditional remedies used in the futures industry of arbitration and court litigation." *Id.* at 861.

[6] Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, 88 Stat. 1389 (1974) (current version at 7 U.S.C. § 18 (1982)).

[7] Section 309 of the Packers and Stockyards Act of 1921, 7 U.S.C. §§ 209-10 (1982) contains the reparations provisions. The USDA recently amended its rules of practice for such proceedings to eliminate an oral hearing as of right for claimants in cases of less than $10,000. 9 C.F.R. § 202.111 (1987). In so doing, the USDA copied a practice already in effect at the CFTC for claims of less than $10,000. 17 C.F.R. §§ 12.200-.210 (1987).

[8] In his testimony before Congress in 1982, Philip McB. Johnson, then chairman of the CFTC, called the reparations process "the noble experiment." *CFTC Reauthorization Hearings on H.R. 5447 Before the Subcomm. on Conservation, Credit and Rural Development of the House Comm. on Agriculture*, 97th Cong., 2d Sess. 115 (1982) [hereinafter *1982 House Agriculture Committee Hearings*] (supplemental statement of Philip McB. Johnson, Chairman, CFTC).

[9] In his article, Shipe, *Private Litigation before the Commodity Futures Trading Commission*, 33 ADMIN. L. REV. 153, 160-61 (1981), Arthur L. Shipe, an administrative law judge, stated that the "progenitor of [the CFTC reparations program] is traceable, through the Perishable Agricultural Commodities Act, and the Packers and Stockyards Act 1921, to the Interstate Commerce Act, originally enacted in 1887." For another discussion of the origins of the CFTC program, see Markham, *supra* note 2, at 94-98 (pointing out that what may be unique about CFTC reparations process is not existence of a private dispute resolution system, which has long existed at Interstate Commerce Commission and Department of Agriculture, but rather limited appellate review provided in CFTC process as compared to other processes).

[10] One major impetus for the use of ADR methods is the widespread view that the rules of civil procedure are unresponsive to the dispute resolution needs of the public.

the reparations process offers a judicial panel that has expertise in commodity futures law and practice, and unlike industry-sponsored arbitrators, the reparations judiciary is staffed by federal employees who are presumed more neutral and less sympathetic to the industry's perspective than would be arbitrators drawn from industry.

This Article will first review briefly the CFTC reparations program in view of the array of alternative dispute resolution procedures currently used in this country. It will then describe the "typical" case brought in reparations. It will then review the history of the CFTC reparations program and describe its current structure. Next, the Article will analyze the current performance of the program at the CFTC. Finally, it will suggest ways in which the prototype reparations process may be utilized as a dispute resolution technique outside the CFTC.

I. THE PLACE OF REPARATIONS IN THE FIELD OF DISPUTE RESOLUTION TECHNIQUES

Ever since our British jurisprudential forebearers eschewed trial by ordeal for more fact-based means of resolving disputes, there has been a quest to discover a fair, effective, and efficient means of dispute resolution. Our present system of civil litigation is premised on a societal judgment that certain protections are worth their costs. These protections include a formalized, even-handed procedure with extensive discovery,[11] strict rules of evidence,[12] impartial judges, and an assured process of appeal.[13] The costs have been in efficiency and the actual monetary cost of underwriting the litigation process. Our system of civil litigation also rests on the notion that lay decisionmakers, be they judge or jury, are capable of understanding the factual underpinnings of disputes upon which they are called to judge. Our legal system has proven to be costly, complex, and slow. The factual issues in dispute are no longer perceived as being necessarily within the grasp of lay judges and juries. For these reasons, the recent years have seen a renewed quest for dispute resolution techniques that represent an "alternative" to civil litigation.

See Miller, *The Adversary System: Dinosaur or Phoenix*, 69 MINN. L. REV. 1 (1984) (discussing inability of judicial system to adjudicate civil disputes economically and efficiently).

[11] *See generally* FED. R. CIV. P. 26-37 (delineating rules for depositions and discovery).

[12] *See generally* FED. R. EVID. (setting out rules governing proceedings in courts of U.S. and before U.S. magistrates).

[13] *See generally* FED. R. APP. P. (setting out procedures necessary to file appeals).

In his recent article,[14] Philip J. Harter describes nine "major" categories of alternative dispute resolution (ADR). These categories are arbitration, "med-arb," fact-finding, minitrial, mediation, facilitation, convening, conciliation, and negotiation.[15] These techniques feature, in the listed order, a diminishing degree in which decisionmaking power is vested in a neutral third party. Thus, in arbitration, the third-party decisionmaker is frequently vested with plenary authority to decide the dispute (although the decision may be nonbinding). In negotiation, on the other hand, there may not be a third party involved at all. These techniques also feature, in roughly descending order, varying degrees of formality attendant in the dispute resolution process. Thus, conciliation may involve almost no rules or structure, while a fact-finding neutral may be constrained by rigid rules of evidence. Finally, the listed techniques may involve, in no particular order, varying degrees of expertise in the decisionmaker. Thus, in some kinds of disputes, the arbitrators are drawn from the industry in which the dispute arises. For example, fact-finding processes may involve fact-finding by an expert group of scientists.[16]

The reparations program at the CFTC is very much at the formal end of the ADR spectrum. The decisionmaker, either an administrative law judge (ALJ) appointed pursuant to the Administrative Procedure Act,[17] or a "judgment officer" created by the CFTC[18] for the purposes of administering the reparations program, is vested with decisional power akin to a trial judge. The process of fact-finding is quite formal, even for the "voluntary" procedure which is the most informal of the decisional procedures available under the program. The decisionmaker is expected to be expert in the facts and law at issue, and the decisionmaker's jurisdiction is limited almost exclusively to matters arising under the Commodity Exchange Act.[19]

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[14] *See Harter, supra* note 4 (discussing alternatives to APA methods for resolving disputes).

[15] *Id.* at 145.

[16] *See* Edwards, *Alternative Dispute Resolution Panacea or Anathema?*, 99 HARV. L. REV. 668, 680-82 (1986) (arguing presence of a knowledgable and skilled neutral makes arbitration superior to litigation in areas ranging from labor cases to mediating disputes between parents and schools over special education programs); Edelman & Carr, *The Mini-Trial: An Alternative Dipsute Resolution Procedure*, 42 ARB. J. 7, 14 (1987) (citing benefits of using experienced neutrals in government contract disputes).

[17] *See* 5 U.S.C. § 3105 (1982) (describing appointment of administrative law judges).

[18] *See* Rules Relating to Reparations, 17 C.F.R. §§ 12.101, 12.201 (1987) (setting forth functions and responsibilities of judgment officer).

[19] The fact finder may also hear common law counterclaims not arising under the CEA, but which involve the same facts and circumstances that gave rise to the repara-

If the CFTC's reparations program is to have value as an ADR technique, it should provide savings in time and cost, and an ease of process, over civil litigation. Moreover, the expert "judiciary" should provide more swift and accurate resolution of disputes than the "inexpert" decisionmakers of the civil litigation system. The decision should also be less subject to industry pressure and bias than the industry-based arbitration system. As will be discussed below, the reparations program at the CFTC is reasonably well structured to achieve these objectives. The process, however, has only recently shown indications that it can achieve its potential.

II. A "TYPICAL" REPARATIONS CASE

The typical kind of case brought by retail customers of commodity futures, commodity options, and securities usually involves some form of alleged wrongdoing by a brokerage firm and its sales staff in connection with the purchase and sale of the relevant instrument. In these sales practice complaints, the customer usually will allege that the salesperson: (1) misrepresented the risk of the transaction ("You'll make money," etc.; the misrepresentation is often labeled "fraud"); (2) made trades not authorized by the customer; (3) "churned" the customer's account (the allegation of "churning" is that an excessive number of trades allegedly were made for the customer's account for the purpose of generating commissions for the broker); or (4) departed from the customer's express investment purpose.[20]

The resolution of complaints based on fraud and unauthorized trades normally requires a determination of credibility. The decisionmaker must decide who is telling the truth. For this determination, the decisionmaker may have the opportunity to hear testimony or, in the case of voluntary and summary proceedings, may be required to resolve the dispute on the basis of written information, either through interrogatories or requests for admissions.[21] The resolution of a churning charge

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tions complaint. Mallen v. Merrill Lynch Futures, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,003 (N.D. Ga. 1985).

[20] Commission rules provide that a charge that the trades were "unsuitable" is not actionable under the Commodity Exchange Act. *See* Phacelli v. ContiCommodity Services, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,250, at 32,674 (Sept. 5, 1986) (holding that customer who makes knowing and meaningful election to undertake risks of trading cannot recover losses by claiming he should have been warned he was unsuitable for such a risk).

[21] *See* 17 C.F.R. § 12.100(b) (1987) (providing that parties who elect voluntary decisional procedure waive opportunity for oral hearings, to receive written statement of factual findings, to prejudgment interest with reparation award, and to appeal final decisions). Only those claimants who chose the formal decisional procedure are entitled

requires an analysis of all transactions in an account to determine whether the frequency of trades could or could not be justified by market conditions. In both instances, the development of a record from which to decide the case can be quite time consuming,[22] especially in a formal process where the decision must be based on the record because of the opportunity for appeal.

A recently decided case brought by husband and wife complainants *pro se* against a company and an individual account executive provides an example of a typical case.[23] The case commenced in April 1986, with the filing by the complainants of a 32-page, seven count complaint against defendants. The complaint alleged that defendant and its employee had: (1) violated CFTC and commodities exchange margin requirements (i.e., had not required the plaintiffs to maintain the required ratio of funds in their account to properly cover potential losses); (2) misrepresented material facts; (3) made unauthorized trades in the complainants' account; and (4) churned their account.[24] As part of the complaint, the complainants included selected account statements.[25]

In early May, when the complaint was completed, the CFTC's Office of Proceedings notified defendants of the complaint and required an answer by June 20. On June 20, defendants responded with a 17-page answer and counterclaim. Appended to the answer were more than 100 pages of account statements and confirmation slips (the paper record of the transactions made in the customers' account), plus pages of customer agreements and disclaimers. On or about July 18, the complainants filed an answer to defendants' counterclaim, and on August 20 the pleadings were forwarded to the hearing section of the Office of Proceedings for assignment to an administrative law judge.

The next stage of the proceeding was occupied with discovery. The rules for reparations proceedings do not permit oral discovery, such as depositions, but do permit interrogatories, requests for admissions, and

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to an oral hearing. 17 C.F.R. § 12.312 (1987).

[22] For a general discussion of the delay problem associated with the CFTC reparations program, see Note, *Dispute Resolution in Commodities Futures*, 12 FORDHAM URB. L. J. 175, 187 n.132 (1983-84) (citing GAO Report which found that complainants who originally filed with CFTC in fiscal years 1976, 1977, amd 1978 had to wait an average of 1,729 days (4 years), 1,173 days (3 years), and 1,129 days (3 years), respectively, for completion of the reparations process).

[23] Weddell v. A.G. Edwards & Sons, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,447 (Jan. 21, 1987).

[24] *Id.* at 33,197.

[25] *See id.* at 33,198 (including complainants' original and "credit" balance, total deposits, and FCM commissions charged to securites account).

requests for production of documents.[26] Both parties availed themselves of these latter opportunities by requesting extensive information from each other. The discovery process had its own skirmishing, which required the ALJ to rule on at least one motion.

The hearing in the case was held on November 20, 1986. The hearing itself was relatively short, lasting two hours and forty-five minutes, and producing 114 pages of testimony. The exhibits to the testimony were more extensive, occupying more than 300 pages. Many of the exhibits duplicated materials produced in discovery. At year-end the parties filed post-hearing briefs. Complainants' brief, including exhibits, was several hundred pages long. Less than one month later, on January 21, 1987, the administrative law judge issued his opinion, ruling that complainants had admitted authorizing all trades, found for respondents on all counts, and dismissed the complaint.[27]

III. A Brief History of the CFTC Reparations Program

A. *The Original Process*[28]

In the 1974 amendments to the Commodity Exchange Act, two kinds of adjudicatory procedures were provided: an informal procedure to adjudicate cases in which alleged damages were not greater than $2,500, and a formal procedure for all other cases.[29] The informal procedure was not a formal adjudication within the meaning of the Administrative Procedure Act.[30] It did, however, provide an opportunity for oral hearing and had a presiding officer, rather than an ALJ, as the decisionmaker. The formal procedure allowed an oral hearing before an ALJ if one were requested by the defendant.[31] In addition, the formal procedure's rules permitted discovery, counterclaims, summary disposition, issuance of administrative subpoenas, and interlocutory appeals, i.e., the essentials of a formal hearing as mandated by section 554 of the Administrative Procedure Act.[32]

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[26] 17 C.F.R. § 12.30(a) (1987).

[27] [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) at 33,199.

[28] The rules governing the original process were promulgated by the CFTC on January 22, 1976. Rules Relating to Reparation Proceedings, 17 C.F.R. 180 (1977).

[29] *See* Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, § 104(b), 88 Stat. 1383, 1393 (current version at 7 U.S.C. § 18 (1982)) (providing where amount claimed as damages does not exceed $2,500, hearing is not required; instead parties may conduct depositions or submit verified factual statements to support their contentions).

[30] 5 U.S.C. § 554 (1982).

[31] 7 U.S.C. § 18(b) (1976).

[32] 5 U.S.C. § 554 (1982).

B. The Problems Encountered in the Administration of the Reparations Program from 1974 to 1978

Several problems beset the CFTC's reparations program almost from the outset. One set of problems arose from the uncertain relationship of the reparations process to the arbitration programs administered by the various futures exchanges. Many FCM's included in their agreements with customers a requirement that the customer submit all disputes to arbitration.[33] Although the CFTC did not recognize such so called "pre-dispute arbitration agreements" as effecting a waiver of a customer's right to initiate a reparations proceeding, the Commission would not permit parallel proceedings. Thus, if a complainant had already submitted to arbitration, the reparations process would be stayed pending the outcome of the arbitration process.[34]

A more serious problem was the surge in reparations complaints provoked by the most serious sales-practice issue to surface in the early years of the reparations program, the so-called London commodity options problem.[35] The problem with these instruments first erupted in 1976 when 73 complaints were filed, thereafter increasing to 543 and 680 in the next two years respectively.[36]

The sheer volume of complaints stemming from the London commodity options crisis alone would have created problems for the fledgling reparations program, but the problems were made worse because these instruments were sold mainly by unregistered persons.[37] By March 1978, 62% of the reparations complaints involved claims against options firms, many of which were not registered with the CFTC.[38] Firms and persons who avoid the agency's registration process are often difficult to locate, difficult to serve, and often impossible to collect from. Apart from these practical problems, the Commission was faced with a difficult and important jurisdictional question: did the program have jurisdiction over unregistered salespersons? The statute permitted actions against persons *registered* under the Exchange Act, but was silent about the extension of jurisdiction to those persons whose activities *required* registration, but who failed to register.

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[33] Today, if the FCM agreement includes a mandatory arbitration provision, the agreement must satisfy the six conditions set forth in 17 C.F.R. §§ 180.3(b) (1987). *See also* Ingbar v. Drexel Burnham Lambert Inc., 683 F.2d 603 (1st Cir. 1983) (holding predispute broker-customer arbitration agreements enforceable under Commodity Exchange Act, as long as in compliance with regulations).

[34] Raisler & Geldermann, *supra* note 3, at 541.

[35] *See id.* at 542 n.16 (noting U.S. antifraud statutes were insufficient to regulate the sale of London commodity options in U.S.).

[36] *Id.* at 545 n.28; *see also* COMPTROLLER GENERAL, REPORT TO THE CONGRESS OF THE UNITED STATES, REGULATION OF THE COMMODITY FUTURES MARKETS - WHAT NEEDS TO BE DONE 135 (May 17, 1978) [hereinafter COMPTROLLER'S REPORT] (warning that unless steps to counteract trend are taken, within two years a four-and-one-half year backlog of reparations cases could be expected), *noted in* Raisler & Geldermann, *supra* note 3, at 545.

[37] Raisler & Geldermann, *supra* note 3, at 542.

[38] *Id.* at 542.

In 1978, in *Stucki v. American Options Corp.*, the CFTC ruled that those persons who *should be* registered by virtue of their activities, as well as those who actually are registered, are covered by the Exchange Act.[39] The effect of this decision, which subsequently was ratified by Congress in the 1978 amendments to the Exchange Act,[40] was to increase greatly the number of cases covered by a reparations program already beginning to stagger under its heavy workload. Without the Commission insisting on a corresponding increase in the resources available to the reparations program, the Commission's decision to interpret its jurisdiction expansively did little to enhance the program's effectiveness. Indeed, according to some commentators, the increased workload only succeeded in "impeding" the CFTC's "effort to administer reparations efficiently and expeditiously."[41]

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[39] Stucki v. American Options Corp., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,559 (Feb. 13, 1978); *see also* Raisler & Geldermann, *supra* note 3, at 542-43 (explaining *Stucki* opinion and its later effect on reparations process).

[40] The 1978 amendments changed section 14(a) to read, in pertinent part:

> Any person complaining of any violation of any provision of this Chapter or any rule, regulation, or order issued pursuant to this chapter by any person who is registered *or required to be registered* under this chapter may, at any time within two years after the cause of action accrues, [file a complaint with the Commission].

Futures Trading Act of 1978, § 21 (codified as amended at 7 U.S.C. § 18 (1982) (emphasis added). The CEA was again amended in 1982, removing CFTC reparations jurisdiction over unregistered persons. Raisler & Gelderman, *supra* note 3, at 551. The current section 14(a) reads, in pertinent part:

> Any person complaining of any violation of any provision of this chapter, or any rule, regulation, or order issued pursuant to this chapter, by *any person who is registered under this chapter* may, at any time within two years after the cause of action accrues, apply to the Commission for an order awarding actual damages proximately caused by such violation.

7 U.S.C. § 18(a) (1982) (emphasis added).

[41] Raisler & Geldermann, *supra* note 3, at 543 n.20. Any fraudulent conduct committed or any swindle by a con-artist became potentially actionable under the reparations provision. *Id.* at 543 n.20; *see also* testimony of Philip McB. Johnson, Chairman of the CFTC, in the 1982 House Operations Committee Hearings:

> [T]he Commission proposes that the program be limited to claims against persons who are actual registrants under the act. At present, the program is required to entertain claims against non-registrants if they should have been registered with the Commission. These individuals or firms are typically unknown to the Commission, and many are in bankruptcy or receivership by the time when reparations claims are filed. And, because these persons have not registered, the Commission is unable to monitor their business practices for the purpose of trying to reduce the level of customer complaints against them.

Accomplishing service of process against unregistered persons created another problem for the Commission. The Commission frequently did not have a proper address for an unregistered person for the purpose of serving process. In 1978, after grappling with the problem for a few years, the CFTC decided in *Troll v. Lloyd Carr & Co.* that "constructive" service of process would be sufficient to serve missing respondents.[42] While this decision solved the problem of effecting service, it greatly exacerbated the CFTC's ability to collect awards. After the *Troll* decision, a complainant could easily obtain a default judgment against an absent unregistered person, but the victory was hollow, since in many instances collecting the award was impossible.[43]

The final important difficulty to beset the early years of the reparations program was inflicted by a decision of the Commission itself. In *Antoniolli v. Clayton Brokerage Co.*,[44] the Commission ruled that once a complaint and answer were technically complete and had been referred to an ALJ, the ALJ was obligated to try the case.[45] The ALJ could not dismiss the complaint on the pleadings, even if the complaint was patently defective.[46] This decision increased the workload of a program already staggering from the impact of the London commodity options crisis.[47]

In the CFTC's 1978 reauthorization hearings, congressional committee members heard much about the slowness and ineffectiveness of the reparations process.[48] Congress nonetheless enacted into law the Com-

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> It is virtually impossible to intelligently manage the program as long as it is vulnerable to sudden surges of claims against previously unknown respondents, and, even when these cases are decided, the awards are frequently totally uncollectable. The entire reparations program suffers from these unexpected shock waves, to the detriment of claimants generally.

1982 House Operations Committee Hearings, *supra* note 5, at 12.

[42] Troll v. Lloyd Carr & Co., [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,676 (Sept. 22, 1978); *see also* Raisler & Geldermann, *supra* note 3, at 544 (explaining lack of actual receipt of complaint not a bar to jurisdiction over respondent).

[43] *See* O'Brien v. Williston Corp., [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,180 (Mar. 24, 1981); Nobel v. Williston Corp. [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,227 (July 24, 1981).

[44] [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,546 (Jan. 18, 1978).

[45] *Id.* at 22,249.

[46] *Id.* at 22,250.

[47] Raisler & Geldermann, *supra* note 3, at 544-45.

[48] *See Reauthorization of the Commodity Futures Trading Commission: Hearings Before the Subcomm. on Agricultural Research and General Legislation of the Senate Comm. on Agriculture, Nutrition and Forestry*, 95th Cong., 2d Sess. 449 (1978) [hereinafter *1978 Senate Agricultural Committee Hearings*] (discussing ineffiencies in reparations process).

mission's opinion in *Stucki* that unregistered persons were within the Commission's jurisdiction for the purpose of reparations proceedings.[49] The only real measure to respond to the backlog of complaints was the raising of the jurisdictional amount from $2,500 to $5,000 for invoking the formal process.[50] Without an increase in resources available to the reparations program, however, these actions were hardly sufficient to overcome the problems created by *Stucki*, *Troll*, *Antoniolli*, and the flood of cases prompted by the London options crisis. Indeed, the problems worsened.

C. The Program from 1978 to 1982

From 1978 to 1982 the Commission struggled to manage a growing problem in the administration of the reparations program. The demand for the services of the program far outpaced the Commission's ability to respond. During fiscal year 1973, 903 complaints were filed. This number rose dramatically again in 1980 to 1,401, and to 1,412 in 1981.[51]

Along with the increased demand came an increase in the backlog of cases. During 1979, there were 68 cases decided, although there were 343 docketed.[52] In 1980, these numbers climbed to 89 cases decided out of the 700 cases pending. In 1981 there were 201 cases decided out of the 1,172 pending. Finally, in 1982 there were 230 cases decided out of 1389 docketed. Of the 230 cases decided, 127 were rendered by one presiding officer, while the remaining 103 decisions were issued by the CFTC's four ALJ's.[53]

Adding to the causes of the backlog was the 1980 crisis in the silver markets, which created another ground swell of unhappy commodity futures retail customers. The reparations unit itself was beset with internal problems, which were chiefly budgetary but also managerial. For example, the Chief ALJ created a bottleneck in the assignment of cases, often holding them for a year.[54] As for budgetary problems, the years from 1978 to 1982 were not bullish ones for federal regulatory agencies. With deregulation the prevailing philosophy, it was particularly difficult for a fledgling agency like the CFTC to garner sufficient resources for its programs. One consequence of the budget crunch was to restrict travel to locations distant from Washington, requiring the ALJ's to "save up" cases to distant sites.[55] The saving of travel money, however, was costly in terms of efficiency. Also, because of the difficulties involved in locating unregistered persons, even when the Commission saved up cases, the unregistered respondent often did not appear at the hearing.[56]

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[49] Futures Trading Act of 1978, Pub. L. No. 95-405, §§ 21(2)-(3), 92 Stat. 865 (1978).

[50] *Id.*

[51] Raisler & Geldermann, *supra* note 3, at 547 (citing COMPTROLLER'S REPORT, *supra* note 36, at 135).

[52] *Id.* at 547 n.46.

[53] *Id.* at 547 n.46.

[54] *1982 House Operations Committee Hearings*, *supra* note 5, at 870. In discussing this problem, the GAO noted the Chief ALJ's hesitation in assigning complaints. The Chief ALJ was concerned that assignment to the other ALJ's would result in them being overburdened with questions and telephone calls from the parties. *Id.* at 870. The GAO suggested that (1) the Chief ALJ develop standards to encourage presiding of-

In addition, other possible forums for hearing claims were either not available or were of uncertain quality. There were uncertainties over access to federal civil courts for complaints arising under the Exchange Act. In addition, the lower federal courts had given a mixed reaction to the existence of a private right of action, and the Supreme Court had yet to resolve the issue.[57] But the uncertainty ended in May of 1982, when the Supreme Court in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, held that a private right of action under the Exchange Act had been retained when the Act was amended in 1974.[58] Shortly thereafter, Congress amended the Act to specifically include, *inter alia*, a statutory private right of action.[59]

During this period, the use of self-regulatory organization arbitration programs was not popular. Section 5a(11) of the Act[60] required contract markets to offer arbitration facilities. The Commission had hoped that use of contract market arbitration would reduce demand on the

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ficers to maintain productivity, *id.* at 861; and (2) the Chief ALJ should assign cases immediately, and to avoid overburdening the ALJ's, a qualified staff person should be designated to answer the parties' questions concerning the reparations process. *Id.* at 870.

[55] Memorandum from Judge Hunt to Judges Duncan, Painter, and Shipe (July 31, 1981) (discussing hearing itineraries and budget constraints). The letter noted the agency's "budgetary strictures" required "economies in all areas," and noted that travel for hearings was "one of the areas in which cost effectiveness may be achieved."

[56] Raisler & Geldermann, *supra* note 3, at 548.

[57] *Compare* Leist v. Simplot, 638 F.2d 283 (2d Cir. 1980) (recognizing a private right of action), *aff'd sub nom.* Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982) *with* Rivers v. Rosenthal & Co., 634 F.2d 774 (5th Cir. 1980) (not recognizing a private right of action), *vacated and remanded*, 456 U.S. 968 (1982).

[58] 456 U.S. 353 (1982). By a five to four vote, the Court ruled that the private right had not been extinguished by the 1974 amendments to the Exchange Act. For an informative discussion of the case, see Miller, *Supreme Court Grants Private Right of Action*, COMM. L. LET., May 1982, at 1.

[59] Futures Trading Act of 1982, Pub L. No. 97-444, § 22, 96 Stat. 2294 (codified at 7 U.S.C. § 25 (1982)).

[60] 7 U.S.C. § 7a(11) (1982).

reparations program, but the procedure was found to be "grossly under utilized."[61] Two problems existed regarding exchange arbitration. The first concern was about the fairness of these forums, and this concern militated against their use.[62] Second, and perhaps more important, there had not yet been established a nationwide self-regulatory organization to administer an arbitration program that would be reasonably accessible to commodity futures complainants. The creation of the National Futures Association and the development of a vigorous arbitration program were still in the future.[63]

D. *The Congressional Hearings of 1982*

In February 1982, in connection with congressional reauthorization hearings for the CFTC, Congress again reviewed the problems with the Commission's reparations program.[64] While the reparations program was by no means the exclusive, or even the most important of the issues addressed by Congress,[65] it did receive attention due to its slowness and complexity and the attention focused upon the issue in a newspaper article.[66]

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[61] Raisler & Geldermann, *supra* note 3, at 550; *see also* 46 Fed. Reg. 60,834, 60,836 (1981) (describing Commission's experience with arbitration rules and announcing adoption of new rules).

[62] *See* Shearson/American Express Inc. v. McMahon, 107 S. Ct. 2332 (1987) (discussing history of mistrust of arbitration); Note, *supra* note 22, at 185-86 (suggesting general belief of pro-industry bias).

[63] *See infra* text accompanying notes 152-63 (discussing initiation of NFA arbitration program).

[64] Three separate congressional committees conducted hearings: the House Committee on Agriculture, the Senate Committee on Agriculture, Nutrition and Forestry, and the House Committee on Government Operations. *1982 House Agriculture Committee Hearings*, *supra* note 8; *CFTC Reauthorization: Hearings on S. 2109 Before the Subcomm. on Agriculture Research and General Legislation of the Senate Comm. on Agriculture, Nutrition, and Forestry*, 97th Cong., 2d Sess. (1982) [hereinafter *1982 Senate Agriculture Committee Hearings*]; *1982 House Operations Committee Hearings*, *supra* note 5.

[65] Much attention was directed to CFTC oversight of exchanges and to the Commission's response to novel market instruments. There was also considerable attention paid to the fledgling National Futures Association.

[66] For a somewhat spirited exchange between Philip McB. Johnson, Chairman of the CFTC, and Congressman Glenn English of Oklahoma, see *1982 House Agriculture Committee Hearings*, *supra* note 8, at 33-34. Congressman English was discussing an article that appeared in the *Washington Post* the morning of the hearing, which purported to describe a draft report critical of the CFTC reparations program from the General Accounting Office. Chairman Johnson said that he had not read the article, and the Congressman responded:

> Mr. English: Let me give you a little bit of the gist of the thing. It says . . . the reparations program which is supposedly to simplify and give people a place to go and complain is taking up to 3 years to work these claims through and costing up to $10,000.

The CFTC offered two proposals for dealing with the program's problems. First, it asked that the Exchange Act be amended to remove the CFTC's jurisdiction over unregistered persons. Second, it asked to be given carte blanche to restructure the procedures for pursuing a reparations claim.[67] In one respect, the Commission was seeking congressional relief from a situation of its own making. The Chairman of the CFTC stated that one of the main difficulties experienced by the CFTC in administering the program was the effect of the *Antoniolli* decision, which prevented ALJ's from dismissing defective claims.[68] The Commission, however, did not request substantial additional resources for the program.[69]

The General Accounting Office (GAO) criticized the reparations program,[70] ascribing fault not only to cumbersome procedures, but also to the Commission's inadequate management of the program.[71] The GAO recommended that the CFTC impose performance standards on

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> Mr. Johnson: As far as the reparations program is concerned, it has been slow. I will admit that it has been slow. We have proposals here to improve it. We intend to improve it.

Id. at 33-34.

[67] *Id.* at 12 (statement of Chairman Johnson). Disappointment with the reparations program prompted the Commission to propose two changes. First, the CFTC sought authorization to redesign the program through rulemaking in order to eliminate delays in cumbersome procedures. *Id.* The new procedures would be designed to maintain fairness, but improve efficiency. Second, the CFTC requested that the program be limited to claims against persons actually registered under the Act. *Id.*

[68] In response to a question in the 1982 House Agriculture Committee Hearings about the reasons for the reparations backlog, Chairman Johnson answered as follows:

> We would hope that through a streamlined procedure we could set up a dismissal procedure so that the administrative law judges could dismiss cases that are clearly unworthy and would not have to take them to trial.

Id. at 26.

[69] Chairman Johnson stated that the Commission did not seek additional powers or to increase regulatory burdens. *Id.* at 105.

[70] Charles A. Bowsher, Comptroller General of the United States, stated:

> The Commission's reparations program . . . is not meeting its objectives. The Commission needs to simplify its rules and procedures. The Commission should also take steps to make arbitration a more attractive and effective alternative to reparations.

1982 House Operations Committee Hearings, *supra* note 8, at 45.

> We have concluded, however, that the reparations program is not meeting Congressional and CFTC objectives that the program be fast, easy to use, and inexpensive. The reparations program is lengthy, relative to the available alternatives of court litigation and arbitration; difficult for complainants to understand; and expensive because most complainants who reach the adjudication stage feel it is necessary to hire attorneys.

1982 House Operations Committee Hearings, *supra* note 5, at 48.

[71] *See 1982 House Operations Committee Hearings*, *supra* note 5, at 48 (stating that because of time and resource constraints and insufficient planning, CFTC has gathered very little management information which would enable effective monitoring and evaluation of the program).

the ALJ's,[72] institute automated management methods,[73] hire a person to answer parties' telephone calls, and rewrite the reparations rules to make them easier to understand.[74] In addition, the GAO promoted the use of self-regulatory organization arbitration programs as an alternative to reparations.[75]

Testimony from the private bar was also critical. Richard A. Miller,[76] who testified as a member of the Committee on Commodities Regulation of the Association of the Bar of the City of New York, called the reparations program a "financial white elephant that [had] siphoned much needed funds and personnel away from the primary duties of the CFTC."[77] Still, Mr. Miller recommended retention of the program because of its "due process advantages, including the opportunity for CFTC and judicial review of reparations decisions."[78] Mr. Miller also rejected the view that arbitration and civil litigation could be a substitute for reparations. He had conducted a cost/benefit comparison between reparations and arbitration, and had concluded that civil litigation was not an alternative because of the "jurisdictional and procedural complexities of civil litigation."[79] Arbitration, he found, was not yet sufficiently "mature" to supersede reparations. He did, however, foresee a day when arbitration would replace reparations, "particularly for smaller cases."[80]

Mr. Miller recommended a two-tiered approach to reparations. For claims of $10,000 or less, he recommended an informal, arbitration-like forum, with no oral hearing and no discovery.[81] This format would then be phased out as the arbitration program of the then-infant National Futures Association matured. For claims greater than $10,000, Mr. Miller recommended the same formal process as then existed, with some technical amendments.[82]

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[72] See *1982 House Operations Committee Hearings*, *supra* note 5, at 871 (noting that performance standards would assist in determing productivity problems). Some ALJ's have taken up to two years after completion of a hearing to write an initial decision. *Id.* at 871.

[73] *Id.* at 880-81. Instituting automated information on the program, it was argued, would allow for more adequate and efficient monitoring and evaluation. *Id.* at 880.

[74] *Id.* at 878. It was believed that rewriting the rules in a simplified manner would result in fewer attorneys being required.

[75] The Comptroller General stated:

> A considerable burden can be shifted from the reparations program by removing certain limitations to increased use of arbitration. To increase the potential for use of arbitration, the Congress should raise from $15,000 to $25,000 the dollar limit for claims that customers can compel exchange members or the National Futures Association to arbitrate. To resolve the issue of the availability of Federal court litigation, the Congress needs to clarify its intent regarding whether customers have a private right of action to adjudicate commodity-related claims in Federal court.

1982 House Agriculture Committee Hearings, *supra* note 8, at 45.

[76] Mr. Miller is also Editor of the *Commodities Law Letter*.

[77] *1982 Senate Agriculture Committee Hearings*, *supra* note 64, at 228.

[78] *Id.* at 228.

[79] *Id.* at 229.

[80] *Id.* at 229.

Mr. Miller criticized the CFTC's request for carte blanche to rewrite the reparations rules because of the vast discretion that would be given the agency. He was particularly concerned that the reparations process not be divorced from its statutory due process underpinnings.[83] He also criticized the CFTC proposal not to regulate unregistered persons.[84]

E. *The Exchange Act Amendments of 1982 and the New Reparations Rules*

The Commodity Exchange Act was amended on January 11, 1983,[85] and in most of the essential provisions, Congress responded to the CFTC's recommendations. Section 14(a) was revised to do away with the *Stucki*[86] amendment of 1978. The 1982 amendments provided that only persons registered at the time of the alleged infraction (or by Commission rules those who *willfully* aided or abetted a registered person) could be pursued under the reparations process.[87] The CFTC did, however, retain jurisdiction over unregistered respondents in cases pending on the effective date of "certain amendments" to section 14.[88]

Section 14(b) was amended to give the Commission broad latitude to fashion workable rules, which was the carte blanche the agency had requested.[89] In addition, section 17(b)(10) was amended to eliminate the $15,000 ceiling for cases that could be arbitrated by self-regulatory organizations.[90] Section 22 was added to explicitly provide for a private right of action under the statute.[91]

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[81] *Id.* at 229.

[82] *Id.* Those technical amendments included: (1) excluding respondents from the reparations program who are in bankruptcy or receivership; (2) amending the statute of limitations period; and (3) imposing specific statutory deadlines on the CFTC to screen complaints. *Id.* at 229.

[83] *Id.* at 229.

[84] *Id.* at 231-232. Thomas A. Russo, the Chair of the Committee on Commodities Regulation of the Association of the Bar of the City of New York agreed that the CFTC should not be given carte blanche. *Id.*

[85] Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (codified as amended at 7 U.S.C. §§ 1-26 (Supp. III 1985)).

[86] For a discussion of the *Stucki* amendment, see *supra* notes 48-49 and accompanying text.

[87] *See* Raisler & Geldermann, *supra* note 3, at 551 (describing new amendments).

[88] 88. *See* Nelson v. Chilcott Commodities Corp., [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,934 (Dec. 12, 1983) (refusing to apply amendments to section 14(a) retroactively).

[89] 7 U.S.C. § 18(b) (Supp. III 1985). It was pursuant to this amendment that the CFTC undertook the extensive revision of its reparations rules that culminated in the publication of final rules on February 22, 1984. 17 C.F.R. § 12.1-.408 (1987).

Within only a few months, the CFTC promulgated regulations implementing the 1982 amendments.[92] These regulations provided for three types of reparations procedures: the voluntary procedure, the summary procedure, and the formal procedure.

1. *The Voluntary Procedure: By the Consent of Both Parties*[93]

This new procedure marked a radical departure from the Administrative Procedure Act's formal adjudicatory process model.[94] The exchange of procedural formalities for greater flexibility and speed put it very much in line with the alternative dispute resolution methods currently in vogue.[95] The process is presided over by a judgment officer, who is an employee of the CFTC Office of Proceedings.[96] The judgment officer may or may not be a lawyer, but in any event, the holders of the position are supposed to be thoroughly familiar with futures industry practice and law.

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[90] Futures Trading Act of 1982, Pub. L. No. 97-444, § 17(b)(10), 96 Stat. 2294, 2322-24 (codified as amended at 7 U.S.C. § 21(b)(10) (Supp. III 1985)).

[91] Futures Trading Act of 1982, Pub. L. No. 97-444, § 22, 96 Stat. 2294, 2322-34 (codified as amended at 7 U.S.C. § 25 (Supp. III 1985)).

[92] Final Rule Relating to Reparations, 49 Fed. Reg. 6,602 (1984) (codified at 17 C.F.R. § 12). In most important circumstances, the regulations applied only to complaints *filed* after that date. *See* 17 C.F.R. § 12.1(c) (1987) (explaining applicability of part 12 rules). Certain sections of the new rules applied to all cases, including those cases pending on April 23, 1982. These included 17 C.F.R. sections 12.14, 12.21, 12.22, 12.23, 12.24 and 12.408. Section 12.14 concerned the timing of withdrawals of complaints without prejudice; section 12.21 concerned dismissal with prejudice; section 12.22 and 12.23 concerned default proceedings; section 12.24 concerned parallel proceedings; and section 12.408 concerned delegation of authority regarding certain procedural appellate motions to the Chief of the Opinions Section of the CFTC.

The new subpart F, concerning the Commission's review of decisions, applied to matters in which initial decisions or "similar dispositive orders," were served on or after April 23. Parties with cases pending on April 23 were allowed to opt by mutual agreement to use the voluntary procedure set forth in subpart C of the new rules.

[93] *See* 17 C.F.R. §§ 12.100-.106 (1987) (describing rules applicable to voluntary proceedings).

[94] 5 U.S.C. § 556 (1982).

[95] One article described the voluntary procedure as a "trend setter in administrative adjudications." Koblenz & Rowland, *CFTC Innovation Under Revised Reparations Rules - The Three Decisional Procedures*, COMM. L. LET., July-Aug. 1984, at 2. The authors suggest that one motivating factor for developing the voluntary procedure was the competition for cases from the courts and the self-regulatory organizations: "The CFTC is competing hard for the business of rendering justice, attempting to beat both forums with faster and cheaper alternatives." *Id.* at 2.

[96] 17 C.F.R. § 12.101 (1987). Judgment officers presided over the voluntary and summary procedures, but not the formal procedures. 17 C.F.R. § 12.101, 12.201 (1987).

Several features of the procedure are designed to enhance speed. Oral hearings are not permitted.[97] In addition, the final decision dispenses with findings of fact, and is simply a conclusory statement of result.[98] The judgment officer's decision is final, with no appeals available to either the Commission or the courts.[99] Perhaps because of the absence of virtually all of the procedures considered critical to due process (e.g., an independent decisionmaker, oral hearing, cross-examination, submission of findings, written decision, and right of appeal), a finding of liability against a commodities professional rendered under this procedure has no collateral effect.[100]

Some features of the voluntary procedure, however, work against speed and efficiency. The formalities of filing a complaint and all supplemental pleadings are the same as those for more formal procedures.[101] Moreover, the voluntary procedure is subject to the same rules of discovery as with more formal proceedings.[102] Thus, depending upon the length of time taken for pleadings and discovery, the voluntary proceeding may or may not save time. Even if the complainant selects the voluntary processes, however, the rules permit the respondent the option of the more formal procedural processes upon respondent's payment of the fee differential between the two.[103] This elective process is novel both for permitting an election of procedure, and for placing the cost of the formal procedure on the requesting party.[104] The filing fees vary depending upon the type of decisional process chosen.[105]

When the new rules were promulgated, the CFTC hoped that decisions under the voluntary process could be rendered in six months. But the backlog of cases existing when the new rules were promulgated made any early realization of this goal, and of the goals for the other decisional processes, infeasible.[106]

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[97] 17 C.F.R. § 12.105 (1987).

[98] *Id.* § 12.106(b) (1987).

[99] *Id.* § 12.106(d) (1987). The Commission will review a decision on its own motion where such review is "necessary to prevent manifest injustice." *Id.* § 12.403(b) (1987). *See generally* Koblenz & Rowland, *supra* note 95, at 8 (describing pros and cons of voluntary proceedings).

[100] 17 C.F.R. § 12.106(b)(3) (1987).

[101] *See id.* §§ 12.103, 12.104 (1987) (providing procedures for filing documents and amending pleadings, and prohibiting most motions).

[102] *Id.* § 12.100(a) (1987). Discovery is limited to requests for admissions, the production of documents, and written interrogatories. None of the processes permit oral depositions as part of discovery. *Id.* § 12.30(a).

[103] *Id.* § 12.25(b)(2) (1987). The formal procedural process applies only if the amount sought exceeds $10,000. *Id.* § 12.26(c).

[104] Procedures for resolving most disputes before other agencies are either formal or informal, leaving the citizen with no other choice. For an example of an informal procedural process, see the Federal Trade Commission's (FTC) dispute resolution process concerning problems with product warranties. 16 C.F.R. §§ 703.1-.8 (1987). By contrast, see the formal processes involved in bringing an unfair labor practice suit before the National Labor Relations Board (NLRB). 29 C.F.R. § 102 (1987).

[105] 17 C.F.R. § 12.25 (1987).

2. *The Summary Procedure: Claims of Less than $10,000*[107]

The summary proceeding is essentially identical to the summary procedure that existed before the 1982 amendments. Like the voluntary procedure, it is conducted by a judgment officer, but in contrast an appeal may be had from the judgment officer's decision.[108] Its procedural and decisional formalities are greater than the voluntary proceeding, but not as extensive as the formal proceeding. For example, the judgment officer's opinion includes findings of fact, but the procedure does not permit parties to file briefs proposing findings of fact and conclusions of law.[109]

Its novel feature provides for a telephonic hearing in some circumstances, when deemed "necessary or appropriate."[110] In ordinary circumstances, however, the hearing is a paper hearing. An in-person oral hearing may be held in Washington, D.C., when resolution of factual disputes justifies it, and the parties consent to the required travel.[111] The original target for rendering decisions is nine months from the filing of the complaint.[112]

3. *The Formal Procedure: Claims Greater than $10,000*[113]

The formal procedure is in most respects the traditional formal hearing procedure contemplated by section 554 of the Administrative Procedure Act.[114] For example, the hearing is conducted by an ALJ. There are, however, three distinct and somewhat controversial features of this proceeding. First, the rules provide that the proceedings officer will rule on all discovery matters, with an appeal to the ALJ available.[115] Second, the rules provide that in most ordinary circumstances, formal hearings conducted outside of Washington, D.C., may be held only in a selected list of 20 cities.[116] Finally, the rules permit the ALJ to dispense with an oral hearing altogether when the written submissions are sufficient to resolve disputed factual issues.[117] The original hope was that decisions would be rendered in one year from the filing of the complaint.[118]

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[106] When the new rules were promulgated, the case backlog was severe. The four ALJ's had a combined backlog of more than 500 cases, and the two judgment officers' backlog came to 142 cases. Letter from R. Britt Lenz, Director, Office of Proceedings, CFTC (Apr. 10, 1987).

[107] 17 C.F.R. § 12.200-.210 (1987).

[108] *See id.* §§ 12.207(e), 12.210(d) (providing right of appeal from judgment officer's order granting summary deposition as well as initial decision).

[109] *See id.* § 12.210 (1987) (outlining judgement officer's duty to make initial decision).

[110] *Id.* § 912.209(b). The judgment officer has sole discretion to allow oral testimony. *Id.* § 12.208(b). If allowed, the testimony may take place by telephone if the party elects. *Id.* § 12.209(b).

[111] *See id.* § 12.209(a) (explaining steps required to access oral testimony).

[112] The filing fee is $100. *Id.* § 12.25(a)(2).

[113] *See id.* §§ 12.300-.315 (1987) (outlining rules applicable to formal proceedings).

[114] 5 U.S.C. § 554 (1982).

4. *The Appellate Process*[119]

The main change in the appellate process is that an appeal to the Commission is no longer by certiorari but rather now is of right.[120] The Commission need not render an opinion, but instead may summarily affirm. This does not, however, mean that the Commission has adopted the rationale of the lower decision; nor will the lower decision then have precedential effect.[121] To ensure procedural and technical correctness, the Chief of the Opinions Section of the CFTC Office of General Counsel is given significant control over the appeals process.[122]

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[115] 17 C.F.R. § 12.301 (1987). The three controversial features of the formal proceeding are: (1) the "proceedings officer" provision, which involves functions similar to a magistrate and the giving of assistance to the ALJ's; (2) the limitation of hearing sites to twenty selected cities; and (3) discretion of the ALJ whether to grant an oral hearing.

[116] *Id.* § 12.312(b). The statutory choice of cities is eclectic. For example, Houston, Texas is on the list, but not Dallas. St. Petersburg, Florida is on the list, but not Miami. Kansas City, Missouri, is on the list, but St. Louis, Missouri, is not. *Id.*

[117] *Id.* § 12.406(b).

[118] The filing fee is $200. *Id.* § 12.25 (a)(2).

[119] *See id.* §§ 12.400-.408 (rules for Commission review).

[120] *Id.* § 12.401. The Commission explained that replacing the certiorari procedure with the appeal as of right would eliminate the two step procedure, by which the Commission first reviewed appellant's detailed appplication for review to determine whether to grant review, and then if the application was successful, it reviewed appellant's full brief:

> [The new procedure] will spare the Commission from having to consider the merits of an initial decision and an application for review separately bef[illegible] determining whether to review the issues on appeal and render its own decision in the case. The new appeal procedure would also relieve a burden imposed on parties by the Commission's former reparation rules that required parties to file a detailed and time-consuming application for review which often resembled a brief, followed by, if review was granted, a brief in support of the issues raised in the application for review.

49 Fed. Reg. 6602, 6620 (1984).

[121] 17 C.F.R. § 12.406(b) (1987).

[122] *See id.* § 12.408 (explaining list of functions belonging solely to chief of

5. *Other Features of the Reparations Program*

In order to enhance efficiency, certain other generic changes or decisions were made in connection with the new rules. The Commission decided not to permit third party claims, reasoning that a third party practice would unduly complicate the reparations program.[123] The Commission also vested in the Director of the Office of Proceedings plenary authority to decide whether a complaint should be sent on to an ALJ or judgment officer for hearing and decision.[124] The vesting of such authority in a nonjudicial officer is quite significant because the decision regarding the disposition of the complaint is not reviewable,[125] and there are no formal standards to guide the Director's discretion.[126] For this reason, and out of a sense of fairness, the present Director errs on the side of inclusion in deciding on the adequacy of the complaint.[127] If there is any question as to the validity of the complaints it is forwarded to an ALJ or judgment officer.[128]

The regulations also incorporated an organizational change. The Commission consolidated those offices involved in the nonappellate aspects of the reparations process into one office, the Office of Proceedings.[129] The CFTC initiated this change in the hope of creating a more effective and efficient administrative structure.[130]

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opinions).

[123] 49 Fed. Reg. 6602, 6605 (1984).

[124] *Id.*

[125] The Commission's determination to keep such authority in the Director was coupled with an unwillingness to permit respondents to file motions to dismiss in lieu of answers. Under the rules, the respondent must answer a complaint that has been forwarded, but may accompany that answer with a "motion for reconsideration of the determination to forward the complaint." 17 C.F.R. § 12.18(b) (1987).

[126] The Commission rejected comments proposing the establishment of such standards. 49 Fed. Reg. 6602, 6610 (1984).

[127] Interview with R. Britt Lenz, Director, Office of Proceedings, CFTC (Mar. 27, 1987).

[128] *Id.*

[129] 17 C.F.R. § 12.2(h) (1987).

[130] *See* Raisler & Geldermann, *supra* note 3, at 555 (discussing CFTC organizational changes affecting regulations).

CFTC REPARATIONS PROGRAM[131]

	Voluntary	*Summary*	*Formal*
Damage amount claimed	any amount	$10,000 or less	more than $10,000
Deciding employee	judgment off.	judgment off.	ALJ
Discovery	yes/limited[132]	yes	yes
Hearing rights	no	phone/D.C.	20 major cities
Written decision	no fact findings	brief fact & law concl.	full fact & law concl.
Appeal rights	no	full	full
Fee	$25.00	$100.00	$200.00

In sum, the new rules sought to address the problems of the old rules in several ways. To remedy the problem of a lack of speed, the arbitration-like voluntary procedure was created. To address the case load bottleneck created by the Chief ALJ, authority to assign cases was vested in a CFTC employee. To remedy the general ALJ caseload bottleneck, the CFTC increased the number of cases that can be disposed of by a person who is not an ALJ, and created a proceedings officer to perform like a magistrate. With respect to the problems of travel, the new rules let nontraveling employees dispose of more cases, increased the number of cases that could be decided on the basis of documentary proof, and limited travel to 20 cities. To remedy the delays caused by the discovery process, the CFTC limited available discovery time. Finally, to remedy the backlog of cases before the Commission, the CFTC eliminated the certiorari process.

6. *Reaction to the Reparations Program*

When the rules were first proposed, the reaction was not altogether favorable. From within the CFTC, one ALJ described the rules as "unnecessarily complex and prolix" and advised that for unsophisticated parties the extensive rules would be too complicated to master.[133] He was also critical of both the summary and voluntary procedures. He argued that parties were being "induced, through an array of burdens incident to the exercise of their due process rights, and promised benefits incident to the forfeiture thereof," to opt for the voluntary procedure, a procedure he regarded as being particularly unsuited to the resolution of serious disputes.[134] And, he noted, for those consigned to the summary procedure, the routing was not even voluntary.[135] Another ALJ was displeased with the proceedings officer: "I object to anyone else making preliminary determinations — especially on discovery — regarding my assignments."[136]

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[131] An excellent and comprehensive chart summarizing the three procedures may be found in Koblenz & Rowland, *supra* note 95, at 3.

[132] In voluntary proceedings, discovery can be requested only by the parties. 17 C.F.R. § 12.34 (1987). The summary and formal proceedings permit the decisionmaker to conduct discovery on his own motion. *Id.* § 12.34. Oral discovery is not permitted in any of the proceedings. *Id.* § 12.30(a).

The private bar was also skeptical. The vice president and senior counsel in Shearson/American Express' commodities division believed that the rules should have encouraged private arbitration through the National Futures Association.[137] A member of the plaintiffs' bar believed that the rules were too complex and would discourage litigation.[138] Plaintiffs' lawyers also believed that an appeal as of right with only a 50-dollar filing fee would encourage delay. In response, a CFTC attorney pointed out that the judicially sanctioned favoring of prejudgment interest in damage awards would reduce the incentive to delay, especially for defendants.

All sides disliked the idea of telephonic hearings. The representative from Shearson/American Express characterized it as "horrible,"[139] and a member of the New York bar noted the paradox of testing the credibility of commodities salesmen over the telephone.[140] The argument is that it is difficult to imagine how an ALJ could assess the credibility of a man by telephone when the charges against him are that he is a con man who operates by telephone. Indeed, part of the skill of a salesman is to be persuasive on the telephone.[141]

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[133] Arieff, *CFTC Reparations Rewrite Wins Little Support*, Legal Times, Aug. 29, 1983, at 2 (quoting memorandum from Arthur L. Shipe to CFTC).

[134] Letter from Arthur L. Shipe to the CFTC (July 19, 1983) (commenting on proposed new reparation rules).

[135] *Id.*

[136] Arieff, *supra* note 133, at 2 (quoting ALJ William Sprull).

[137] *Id.* at 2 (mentioning views of Michael H. Hogan).

[138] *Id.* at 2 (mentioning views of M. Van Smith).

[139] *Id.* at 2 (arguing that live cross-examination is more effective).

[140] *Id.* at 2 (Mr. Nathan arguing that you cannot judge credibility of an experienced salesman over the phone).

[141] *Id.* One of the incumbent judgment officers thinks the telephonic hearing works against those who are glib, and so he differs with Mr. Nathan's judgment. Interview with Judgment Officer Joost (Mar. 4, 1987).

Other critics focused less on the particular details of the new rules than on the overall compromise of procedural safeguards manifest in the summary and voluntary procedures.[142] One group of authors praised the CFTC's attempt to provide a menu of procedural choices as showing "inventiveness and flexibility,"[143] but thought that too much had been compromised away. The group also objected to denying the small claimant the opportunity to opt for the formal procedure.[144]

There were also a host of comments relating to particular details of the process, such as the length of time for responding to a complaint, extensions of time to file pleadings, and interlocutory relief.[145] Other comments focused on the number of copies of pleadings required for filing, and whether pleadings should be considered filed when received or when posted.[146] Still others addressed the filing fee amounts required,[147] but these comments obviously did not reach the more interesting and important issues raised by the new rules.

IV. THE REPARATIONS PROGRAM SINCE THE CFTC AMENDMENTS OF 1983

Because the new reparations rules have now been in effect for several years, there is a reasonable opportunity to assess their performance. Moreover, two other events which affect the program occurred almost simultaneously to the amendments of the Exchange Act, and have made it easier to assess the program's performance. First, the National Futures Association (NFA) initiated in March 1983 a comprehensive arbitration system.[148] This program has provided a forum for the informal resolution of disputes arising under the commodity futures laws.[149] Second, the Supreme Court's 1982 decision in *Merrill Lynch, Pierce, Fenner & Smith v. Curran*,[150] which upheld a private right of action under the Exchange Act, was subsequently codified in the Exchange Act amendments of 1982.[151] The recognition of such a right has provided an alternative forum for the formal resolution of major commodities law claims.

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[142] *See* Koblenz & Rowland, *supra* note 95, at 9 (providing general outline of three procedures).

[143] *Id.* at 9.

[144] *Id.* at 10.

[145] 49 Fed. Reg. 6602, 6605 (1984).

[146] *Id.* at 6605-06.

[147] *Id.* at 6609.

[148] Note, *supra* note 22, at 189 n.149.

[149] *Id.* at 188-91.

[150] 456 U.S. 353 (1982).

[151] Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (codified at 7 U.S.C. § 25 (Supp. III 1985)).

A. *Arbitration*

The purpose of the CFTC's reparations program is to provide a simplistic, inexpensive, and expedient forum for dispute resolution.[152] Both the CFTC and the GAO believe that self-regulatory organization arbitration programs can provide many of the same benefits as the reparations program. But until recently, arbitration did not fulfill its potential as an ADR technique. This has now changed in three important respects. First, Congress amended the CEA to eliminate the upper limit on arbitrable claims.[153] Second, through rule changes the CFTC expanded those subject to arbitration to include commodity pool operators and commodity trading advisors,[154] and required the self-regulatory organizations to provide a "mixed panel" comprised of a majority of non-exchange-affiliated persons, upon request of the complainant.[155] Third, and most important, the National Futures Association arbitration program was established,[156] and its program began just three months after the Exchange Act was amended.[157] Since its inception, there has been a steady growth in interest and use of the NFA arbitration program.[158]

The growing use of NFA arbitration may be attributed to the nationwide scope of the program. In 1986 it expanded its roster of qualified arbitrators to 1,410, up from 725 arbitrators in the previous year.[159] The encouragement and support of the CFTC also contributed to the growth of NFA arbitration. The CFTC Office of Proceedings, which supervises the reparations program, includes literature on self-regulatory organization arbitration in the materials it sends to individuals seeking information about reparations.[160] By publicizing the availability of NFA arbitration, the CFTC is expressing its own belief in the potential of self-regulatory organization arbitration and acting in accord with the GAO's endorsement of such a program.[161] Furthermore, the CFTC may also be diverting cases from its own reparations program. In years corresponding to the growth of NFA arbitration, the number of complaints filed with the CFTC has diminished.[162] Significantly, the NFA is now a competitor with the CFTC for ADR business.[163]

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[152] *1982 House Operations Committee Hearings*, *supra* note 5, at 861.

[153] Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (amending 7 U.S.C. § 21(b)(10) (1982)). *See* Miller, *CLL Report on Commodities Litigation: New Statute, Arbitration & Reparations Rules Affect Plaintiff's Choice of Forum*, COMM. L. LET., July-Aug. 1983, at 8, 9 (stating upper limit on arbitration claims and counterclaims was eliminated). In so doing, Congress was acceding to a request from the CFTC. *1982 House Agriculture Committee Hearings*, *supra* note 8, at 128. In general the CFTC advocated statutory and regulatory changes designed to make arbitration a more attractive alternative to reparations than it had been earlier.

[154] 17 C.F.R. § 180.3(b) (1987); *see also* 48 Fed. Reg 22,138 (1983) (discussing impact of additions).

[155] 17 C.F.R. § 180.3(b) (1987).

[156] *See generally*, Rosen, *Arbitration Before the National Futures Association*, COMM. L. LET., Jan.-Feb. 1987, at 3; Note, *supra* note 22, at 188-91 (praising NFA arbitration and concluding CFTC's obligation to improve reparations program could be accomplished by encouraging NFA arbitration).

[157] 1985 NAT'L FUTURES ASS'N ANN. REV. 13.

[158] In 1984, 270 information requests were filed, but there were only 82 demands for arbitration and 23 hearings conducted. In 1985, the figures more than doubled as 652 parties requested information and 60 hearings were conducted. *Id* at 13. Finally, in 1986 there were 884 information requests, 272 demands for arbitration, and 92 hearings. 1986 NAT'L FUTURES ASS'N ANN. REV. 9.

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[159] *Id.* at 9.

[160] *Id.* at 20.

[161] *1982 House Operations Committee Hearings, supra* note 5; GAO Report, *Reparations and Other Presently Available Forums for the Resolution of Customer Claims are Inadequate*, at 861-97. The GAO expressed great hope in NFA because it lacks the structural defects of exchange arbitration, but added that:

> . . . if NFA arbitration is to reach its full potential, it will require substantial cooperation between the industry and CFTC. To ensure that commodity customers are aware of the NFA's arbitration program, the industry and CFTC must educate and inform the public regarding the existence of the program and how it works. CFTC must also monitor the program to make certain that the NFA is adhering to CFTC approved rules and procedures.

Id. at 889; *see also 1982 House Agriculture Committee Hearings, supra* note 8, at 177 (statement of Henry Eschwege, Director, Community and Economic Development Division, GAO) (arguing Commission should attempt to make arbitration more attractive alternative to reparations).

Another reason for the increase in the use of arbitration to resolve customer disputes relating to commodity futures is that courts generally have not extended the doctrine of Wilko v. Swan, 346 U.S. 427 (1953) to commodity customers. *See* Olsen v. Paine, Webber, Jackson & Curtis, Inc., Comm. Fut. L. Rep. (CCH) ¶ 23,072 (N.D. Ind. 1986) (ruling that legislative history of Commodity Exchange Act indicates agreements to arbitrate enforceable). In *Wilko* the court ruled that a predispute arbitration agreement was unenforceable against a securities customer. For a good discussion of why the courts have distinguished commodity futures customers from securities customers, see Smoky Greenhaw Cotton Co. v. Merrill Lynch, Pierce, Fenner & Smith, 720 F.2d 1446, 1449 (5th Cir. 1983) (Commodity Exchange Act emphasizes extra-judicial resolution of disputes, whereas securities acts do not). But as the Fifth Circuit noted in *Smoky Greenhaw Cotton Co.*, the CFTC has created its own *Wilko* doctrine by promulgating a regulation that advises commodity customers that signing an arbitration agreement does not effect a waiver of the right to proceed by reparations. *See* 17 C.F.R. § 180.3(b)(4) (1987) (requiring all arbitration agreements to feature in block letters notice to customers that "your consent to such an agreement be voluntary" and that customer need not sign agreement in order to open account).

The *Wilko* holding, even as it applies to the securities laws, has been limited severely by the Supreme Court's recent decision in Shearson/American Express v. McMahon, 107 S. Ct. 2332 (1987). The Court held that pre-dispute arbitration agreements were valid for claims arising under section 10(b) of the Securities Exchange Act of 1934. *Id.* at 2341.

[162] Several ALJ's agree that the NFA's program has diverted cases from the CFTC. Interviews with Judges Spruill, Painter & Shipe (Oct. 24, 1986). Furthermore,

B. *Private Right of Action*

Commodity futures litigants have gained greater access to civil federal courts since the Exchange Act was amended in 1983.[164] However, even before the Exchange Act was amended, the *Curran* case recognized an implied private right of action in commodities futures cases.[165] Congress amended the Exchange Act to expressly provide a private right of action to persons injured under the Exchange Act.[166] Under the provisions of the revised statute, a complainant is subject to a two-year statute of limitations and may receive actual damages, but not punitive or consequential damages.[167]

Rights under the statute may be broader than cases covered by *Curran* because the judicial interpretations of *Curran* by the lower courts were not expansive. In general, lower courts have denied private actions for claims that would not have been available to private litigants when the Commodity Exchange Act was amended in 1974.[168] Consequently, courts denied a pre-1982 private action right for a number of important claims, including actions based on aiding and abetting,[169] failure to supervise,[170] and suitability issues.[171] However, the current Act's two-year statute of limitations and the contraints on the types of damages avail-

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when the Commission promulgated the new reparations rules, it conceded that it would reevaluate whether the Commission's voluntary procedure remains necessary after the NFA establishment of the NFA. 49 Fed. Reg. 6602, 6612 (1984). Complaint filings were up, however, 57% in the first two quarters of fiscal year 1987 compared to the same period a year ago. Telephone interview with R. Britt Lenz, Director, Office of Proceedings, CFTC (Apr. 21, 1987).

[163] Competition between any type of program is valuable. For instance, competition for business between the English common law courts and the Court of Chancery is credited with stimulating important advances in English jurisprudence. For an amusing look at the subject of competition between courts, see Orth, *A Reverie on Medieval Judges, Milton Friedman and the Supreme Court*, 1983 A.B.A. J. 1454-61.

[164] Futures Trading Act of 1982, Pub. L. No. 97-444, 96 Stat. 2294 (codified at 7 U.S.C. §§ 1-26 (1982)).

[165] Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran, 456 U.S. 353 (1982).

[166] 7 U.S.C. § 25 (Supp. III 1985). *See generally* Miller, *supra* note 153.

[167] 7 U.S.C. § 25(a)(1), 25(c) (Supp. III 1985).

[168] Evanston Bank v. ContiCommodity Services, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,979 (N.D. Ill. 1985).

[169] *Id*. at 31,874 (citing Johnson v. Chilcott, 590 F. Supp. 204 (D. Colo. 1984)).

[170] *Id*. at 31,874 (citing Bennett v. E.F. Hutton Co., 597 F. Supp. 1547 (N.D. Ohio 1984)).

[171] *Id*. at 31,874 (citing J.E. Hoetger & Co. v. Asencio, 558 F. Supp. 1361 (E.D. Mich. 1983)).

able may not apply to *Curran* cases.[172]

For those claims which fall under *Curran* or within the new statutory provisions, private actions brought in civil court may offer a significant advantage over reparations. Specifically, such an action allows several federal claims to be heard by a single court. For example, in *Evanston Bank v. ContiCommodity Services, Inc.*[173] the bank alleged violations of the Commodity Exchange Act, the Racketeer Influenced and Corrupt Organization Act (RICO)[174] and pendant state statutory and common law claims.[175]

The federal courts are in agreement that the 1974 amendments to the Commodity Exchange Act did not preempt state common law fraud claims stemming from commodity futures transactions.[176] While there is less authority regarding the impact of the 1982 amendments to the Act, at least one court has held that state claims were not preempted by the 1982 amendments.[177]

Aggrieved commodity futures customers now have more places to go with their complaints than they did in 1982, with the result that the reparations program is no longer suffering from a glut of complaints. The question now is whether, given these other forums, particularly the NFA arbitration program, the CFTC reparations program still serves a necessary ADR function.

V. THE PERFORMANCE OF THE REPARATIONS PROGRAM UNDER THE NEW RULES

The following is an assessment of the new reparations rules since they went into effect in April 1984. The assessment below is derived from a number of sources: (1) annual reports of the CFTC; (2) CFTC Office of Proceedings statistical performance summaries;[178] (3) CFTC Executive Office reports to the Commission on the reparations program;[179] (4) an analysis of all reparations decisions rendered under the new rules and reported in the Washington Service Bureau's *CFTC Administrative Reporter*;[180] (5) a review of a sample of reparation case files at the CFTC;[181] (6) memoranda and correspondence obtained from the CFTC; (7) interviews with key CFTC personnel; and (8) contacts with complainants and respondents in recently completed reparations cases.[182]

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[172] Miller, *supra* note 138, at 9.

[173] [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,979 (N.D. Ill. 1985).

[174] 18 U.S.C. §§ 1961-1968 (1982).

[175] *See* Griswond v. E.F. Hutton, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,980 (N.D. Ill. 1985) (cause of actions similar to *ContiCommodity*).

[176] Patry v. Rosenthal & Co., 534 F. Supp. 545, 551 (D. Kan. 1982).

[177] Mallen v. Merrill Lynch Futures, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,003 (N.D. Ga. 1985).

[178] Since at least the first quarter of fiscal year 1983, the CFTC's Office of Proceedings has been keeping records and compiling statistics on caseload receipt and disposition. In addition, performance statistics compiled by the GAO in connection with the congressional hearings of 1982 contain valuable statistical information.

[179] Since the reparations rules were revised, three reports providing statistical

A. *The Impact of the New Rules on Efficiency of Case Disposition*

An important reason for the passage of the new rules was to increase

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data on the progress of the reparations program have been made. The first is dated January 25, 1985, and covers approximately the first seven months of the reparations program (from April 23, 1984 to November 30, 1984) [hereinafter *CFTC Report No. 1*]. The second is dated June 11, 1985, and covers approximately the first year of the reparations program (from April 23, 1984 to April 30, 1985) [hereinafter *CFTC Report No. 2*]. The third is dated July 25, 1986, and covers the first two years of the reparations program (from April 23, 1984 to April 30, 1986) [hereinafter *CFTC Report No. 3*]. It should be noted that *CFTC Report No. 3*, like the earlier reports, does not provide a breakdown of the time required for the various steps in the three processes.

[180] One hundred thirty-two cases were reviewed. [hereinafter *1985-1987 Analysis of Reparations Decisons*]. They constituted all reparations cases reported in the Washington Service Bureau *CFTC Administrative Reporter* from December 1985 through mid-February 1987 that were decided under the new rules. Several cases, however, were not analyzed because they failed to disclose a filing date. Others could not be subject to full analysis because the reporting occasionally left out a necessary factor. For example, a case might not disclose the award sought.

In addition, the lines were not always clear between cases decided under the old rules and those decided under the new rules because some complaints filed before April 24, 1984 were processed pursuant to the new procedures. For example, in Sunvold v. Clayton Brokerage Co., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,053 (Apr. 30, 1986), the complaint was filed on March 19, 1984, but decided pursuant to the new rules. Similarly, in Simpson v. Chartered Systems Corp., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,107 (June 10, 1986), a complaint that would have originally been processed under the old rules, and thus would have been heard pursuant to a formal proceeding because the amount claimed was $5,051, was heard in 1985 as a summary proceeding.

Cases under the new rules with reported counterclaims are sparse because throughout most of the period in which the new rules have been in effect the Commission has stayed proceedings with common law counterclaims or for which appeal might be had to the Court of Appeals for the District of Columbia Circuit. The Commission did so because of the August 13, 1985 decision in *Schor v. Commodity Futures Trading Commission*, where the D.C. Circuit held that the CFTC lacked jurisdiction to hear such counterclaims. 740 F.2d 1262 (D.C. Cir. 1985). On July 7, 1986, the Supreme Court reversed the D.C. Circuit opinion in *Schor*, 106 S. Ct. 3245 (1986), and on August 5, 1986, the Commission lifted its stay. *See* In the Matter of Various Reparation Proceedings in Which Counterclaims have been Filed and Judicial Review is or May be Available in the United States Court of Appeals of the District of Columbia Circuit; Crump v. A.G. Edwards & Sons, Inc., [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 23,186 (Aug. 5, 1986).

[181] *See infra* notes 220-26 and accompanying text (section VI(b)).

[182] *See infra* notes 208-20 and accompanying text (section VI(a)).

the efficiency with which the reparations process was conducted.[183] But it is difficult to draw conclusions about the success of the rules in achieving this efficiency because even before the new reparations rules became effective there was a diminution in the number of reparations complaints docketed with the hearings section of the CFTC. For example, in 1981 there was a large increase in the number of cases disposed of by the hearings section. There were 818 complaints docketed in 1981,[184] the year after the silver crisis erupted, but only 610 complaints docketed the following year.[185] The number docketed in fiscal 1984, 286, seems inordinately low, and is the result of two phenomena relating to the institution of the new rules in the middle of that year.[186]

These numbers suggest that the tapering off of crisis-generated complaints, rather than new procedures offered by the rules, may account for at least some of the increased efficiencies at the CFTC. At least three of the four CFTC ALJ's ascribe the diminution in backlog to factors other than the efficiencies of the new rules. One ALJ asserted that the absence of market crises, coupled with the infusion of personnel and computer equipment into the Office of Proceedings, was largely responsible for the improved efficiency in the program.[187] Early in the new program, another ALJ objected to crediting the new procedures with the reduction in case backlog, stating that the reduction in complaints was attributable to a "quiet market" as much as the new rules.[188] The third ALJ believed that the 1982 Exchange Act amendments, which limited jurisdiction to complaints against registered persons, cut down on the number of cases. The first ALJ similarly pointed to a slower market and the jurisdictional limitation as the primary causes for the reduced caseload.[189]

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[183] 1985 CFTC ANN. REP. 97.

[184] 1981 CFTC ANN. REP. 40.

[185] 1982 CFTC ANN. REP. 33.

[186] First, the new rules permitted the dismissal of complaints that were the subject of parallel proceedings, and thus 51 cases which might otherwise have been docketed were dismissed instead. Second, while the new rules were being put into place, there was a slowdown in cases forwarded from the Complaints Section of the Office of Proceedings. *See CFTC Report No. 1*, *supra* note 179, at 5.

[187] *See* Memorandum from Judge Painter to Chairman Phillips (Feb. 1, 1985) (regarding Report on the New Reparations Rules). He attributed the diminution in backlog, among other things, to reduced case filings, the acquisition of word processors, the appointment of an efficient judgment officer, fewer enforcement cases, part-time summer help, and student interns.

[188] Memorandum from Judge Spruill to R. Britt Lenz, Director, Office of Proceedings, CFTC (Jan. 24, 1985).

[189] Interview with Judge Shipe (Oct. 24, 1986).

B. *The Impact of the New Rules on the Speed of Disposition*

In recent years, the CFTC has compiled statistics on processing time for all reparations complaints filed with the Commission.[190] The CFTC data include not only cases that are adjudicated and decided, but also those that are settled or are otherwise disposed of without decision. The average number of days for completion of a voluntary procedure is 145.[191] For a summary procedure the average is 186, and 265 days is the average for a formal procedure.[192]

Results of an analysis by this author of the 132 reparations decisions made by the Hearings Section between the end of December 1985 and the beginning of February 1987[193] vary somewhat from the CFTC's results. The average number of days from the receipt of a complaint by the CFTC to an initial decision was smallest for the least formal procedure (voluntary) and next smallest for the most formal procedure (formal). Interestingly, the elapsed time from complaint to initial decision for the summary procedure was appreciably greater than for either of the other two procedures, including the formal procedure. The average number of days for the voluntary procedure was 488 days. For the summary procedure, the average number of days was 618, and for the formal, the average number was 546.[194]

Although the results of this analysis are revealing, a full-scale time study of the reparation unit's records would be desirable before a proper judgment could be made about the relative efficiencies of the three procedures.[195] It may be, for example, that summary procedures going to decision take longer to process than formal procedures because the CFTC has four ALJ's to judge formal complaints and only two judgment officers to judge both voluntary and summary complaints. Indeed, in the time covered by the sample, the two judgment officers decided 90 cases, and the ALJ's decided only 34.[196] The addition of another judgment officer might well reduce the overall processing time for summary and voluntary proceedings. Thus, although further monitoring is needed, the present information leads to the conclusion that for those summary proceedings that go to decision the hoped for time savings have not yet been realized.

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[190] The Office should within the next several years have an efficient means of tracking and analyzing case dispositions.

[191] *CFTC Report No. 3*, *supra* note 179, at 4, 6.

[192] *Id.* at 4, 6.

[193] *See* sources cited *supra* note 179.

[194] These results represent only those cases which had been adjudicated and for which an initial decision had been rendered. Unlike the CFTC's data, they do not include cases settled before decison, or those dismissed for cause.

The data do not change significantly if only a smaller sample (58) of more recent cases is used to compute the results. The average number of days for voluntary, summary and formal procedure are 529, 676, and 473, respectively, for 31, 18 and 8, respectively.

[195] A time study of a very small sample of reparations cases suggests that summary cases take longer to process at most stages in the process, and not simply the final decisional stage.

It is difficult to make comparisons between the NFA and CFTC programs on the basis of speed since the parameters from which the data bases are derived may not be identical. The NFA's methods for identifying date of receipt, for example, may differ from the CFTC's, as may their way of recognizing a "disposition." Nonetheless, the numbers for time from receipt to disposition for the NFA and CFTC are remarkably close. Figures supplied by the NFA show that on an annualized basis, the average time from receipt to award was as follows:[197]

TIME FROM RECEIPT TO AWARD IN NFA ARBITRATION

Year	*Average Time*	*Number of Cases*
1983	7.4 months	45
1984	6.7 months	124
1985	8.5 months	196
1986	4.8 months	88[188]

When the figures for 1985 and 1986 are combined, the average time from receipt to award is roughly 7.1 months (or 220 days). This figure may be compared to the CFTC's figures for a roughly similar time.[198] The CFTC reported that the average time from receipt to disposition for its cases was 145, 186, and 265 days respectively for its voluntary, summary, and formal proceedings. The 220-day average for recent NFA proceedings is, at least on an unweighted basis, roughly in between the averages for the CFTC's formal and summary proceedings.

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[196] A third person, no longer with the Commission, decided some summary and voluntary cases. He accounts for eight cases in the 132-case sample.

[197] Letter from the National Futures Association, Marianne K. Smythe (Mar. 26, 1987).

[198] *See supra* notes 191-92 and accompanying text (providing CFTC figures).

C. *The Differences in the Types of Procedures as Reflected in Outcome*

An analysis[199] of the initial decisions of the 132 cases that went to decision reveals a slightly greater percentage of decisions favorable to complainants in the formal and summary proceedings than in the voluntary proceedings. In summary proceedings, 66% of the complainants "won" their case (a complainant was regarded as having "won" if he or she received any portion of the damages claimed). In formal proceedings, 62% won their case. In contrast, only 56% of complainants in voluntary proceedings prevailed on their claims.

The reason for this mild disparity is likely that both parties may have a preference for the formal processes when the case is close or the stakes are high. As noted earlier, the rules permit the respondent to opt for the more formal procedural processes, even if the complainant selects the voluntary process, upon respondents payment of the difference in fee. It can be concluded that respondents only risk voluntary (and therefore nonappealable) proceedings for those cases which they believe the complainant has a weak case, and elect the more formal procedures for those cases in which respondents believe the issues are closer.[200] If that is the case, the choice of procedure may assist in explaining the disparate results.

The data[201] suggest that when the stakes are high, complainants likewise show a preference for the more formal procedures. Since the inception of the new program, complainants have consistently, by a margin of approximately 60% to 40%, shown a preference for voluntary procedures over summary procedures for claims of less than $10,000. For claims of greater than $10,000, however, the opposite is true. For these claims, complainants choose the formal procedure over the voluntary procedure by a margin of 74% to 26%.[202]

The disparities attributable to the type of procedure involved are far less dramatic than the disparities of outcome among and between the different types of judicial officers. The two CFTC judgment officers who decided most of the voluntary and summary cases differed markedly in their decisions. The first officer decided 46 cases, 74% of which were decided in favor of the complainant. The other officer decided 44 cases, 48% of which were decided for the complainant.[203] On a proportionate basis, however, both officers were more "pro-complainant" in summary than in voluntary proceedings, again suggesting that voluntary cases provide lower risk for the respondents.[204] Overall, the complainants in the 1985-1987 CFTC Study won in 61% of the initial decisions.[205]

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[199] *1985-1987 Analysis of Reparations Decisions*, *supra* note 180.

[200] Comments of two attorneys who represent respondents in these proceedings are consistent with this rationale, as are the views of Judgment Officer Phillips.

[201] *1985-1987 Analysis of Reparations Decisions*, *supra* note 180.

[202] *See CFTC Report No. 1*, *supra* note 179, at 5.

In comparing the CFTC won/lost percentages to those generated over a roughly comparable period of time at the NFA, the potential pro-industry bias of the NFA arbitrators can be found to result in a forum slightly more sympathetic to respondents than is provided by the CFTC reparations program. Figures provided by the NFA show for the period from October 1985 to March 1987 that the claimant won in 74 cases, the respondent won in 5 cases, and no monetary award was provided in 48 cases.[206] Thus, for the 127 judgments in the NFA sample, the claimant won 58% of the time. This is roughly the same winning percentage as complainants coming before one of the CFTC judgment officers in summary proceedings. The winning percentage for complainants in NFA arbitrations is slightly higher (2%) than the winning percentage for complainants in the CFTC voluntary proceedings discussed earlier. The NFA results are 3% lower than the 61% winning percentage for all complainants in the CFTC sample.[207]

VI. CONTACTS WITH RECENT USERS OF THE REPARATIONS PROCESS AND REVIEW OF CASE FILES OF RECENTLY COMPLETED REPARATIONS CASES

To better understand how the summary and voluntary procedures of the reparations process were perceived by those who actually used the process, complainants, respondents, and respondent firms of recently completed reparations cases were contacted. In addition, a review of case files of reparations cases recently completed was conducted. The following is a discussion of the results of those reviews.

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[203] The difference between the ALJ's is equally striking. Judge Shipe ruled in favor of complainants, 83% of the time and Judge Spruill ruled in favor of complainants 82% of the time, but Judge Painter favored complainants only 41% of the time.

[204] Judgment Officer Phillips ruled for complainants 57% of the time in summary proceedings, but only 44% of the time in voluntary proceedings. Judgment officer Joust ruled for complainants 77% of the time in summary proceedings, and 74% of the time in voluntary proceedings. *1985-1987 Analysis of Reparations Decision*, *supra* note 180.

[205] *Id.*

[206] Letter from the National Futures Association to Marianne K. Smythe (Mar. 26, 1987).

[207] *Id.* The data from which these figures are derived, however, may not necessarily be comparable, since the NFA figures may reflect all outcomes, while the CFTC figures reflect only the outcome of cases going to initial decision. In addition, the concept of "wins" and "losses" is overly simplistic in the dispute resolution context. A claimant winning 5% of the amount claimed, for example, might technically be classified as a "winner," but may in reality not have won at all.

A. *Contacts with Recent Users*

A letter and brief questionnaire were sent to the complainants, respondents, and respondent firms of a few recently completed reparations cases.[208] The parties were asked, in essence, for their reactions to the reparations process.

Although only a few responses were received, the answers to the questions varied considerably. For example, the response given by complainants as to whether they would consider using the reparations process again ranged from: "In a similar situation, I would use the process again"; to, "probably"; to, "*Never*. It is just furnishing some shysters an office plus a place of employment." Significantly, those plaintiffs who won their claims were satisfied with the process, and the one dissatisfied complainant had not won. Four of the five complainants found the process too slow. Three found the process easy to understand, although two of those complainants were represented by counsel.

One particularly thoughtful response came from a complainant who found the process overwhelming to the lay person. Her comments encapsulate some of the common elements in the reparations process. She, like most complainants, was *pro se*. The respondent, on the other hand, was represented by counsel. The complainant found the process slow and confusing. Yet she had some perception that her suit served the purpose of informing the regulators about a problem in the industry, as well as providing her with an avenue for potential vindication of her complaint.[209] Despite her misgivings about the process and about her competence to pursue her claim, she persevered and prevailed.[210]

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[208] Because the reparations program provides only a contract damages remedy, with no opportunity for punitive damages or injunctive relief, it would be diffucult to determine from only the record of proceedings what is being sought by a complainant besides monetary compensation. For example, it is possible that a complainant might also want vindication or revenge, or might want to perform some perceived public service by pursuing the respondent. In a study by a consumer fraud bureau in Illinois, 50% of the complainants in the sample group were found to be seeking something other than restitution. Steele, *Fraud, Dispute, and the Consumer. Responding to Consumer Complaints*, 123 U. Pa. L. Rev. 1107, 1138-39 (1975). The study also showed that more than one quarter of the complainants at the high end of the income spectrum (over $17,000 per annum in the mid 1970's) sought a public-oriented remedy. *Id*. at 1140-41. Since one would suspect that commodity futures customers belong in the higher income groups, their satisfaction with the program might not only rest with a monetary reward but might also require some sense that the public good had been vindicated.

[209] The discussion of the responses is derived either from notes of telephone calls,

Of the 12 individual respondents contacted, only three answered.[211] Six (or 50%) of the letters were returned undelivered.[212] The three remaining individual respondents simply did not answer. This response rate may well illustrate the difficulty the CFTC and complainants experience in locating individual respondents, not to mention making them accountable for a judgment. Of the three individual respondents who did answer, none seemed happy with the process. All had lost their cases, and all felt that the process had a pro-complainant bias and was not fair.[213]

Of the 11 respondent firms contacted, only three answered. One letter was returned undelivered, and seven firms simply failed to respond. The most comprehensive and helpful response came in a telephone call from an attorney who has represented a firm in a number of reparations cases, although never in a case using the voluntary procedure. He regarded the voluntary procedure as "strange," because of the absence of a written opinion or the right of appeal.[214] While he regarded the

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or from the written answers on the questionnaire.

[210] The text of the letter is as follows:

> You can't imagine how difficult this was for me to do (I mean choosing to sue). First of all most people cannot write & explain themselves well. Then you don't know if you should be brief or lengthy. One almost wants to quit before beginning. You don't know how many times I wrote and tore up and mentally considered defeat before I started. What kept me going, was knowing in my heart that there were mistruths (sic) and especially when I received lies in writing from the lawyers. I sat down and simply wrote what happened to me and said let the reparation committee decide. I thought at least they will be aware in Washington that [the respondent firm] was not acting in the best interests of their clients but only in their best interests. I wonder how many other people they [the firm] have abused and gotten away with it because most people don't want to be bothered with a lot of aggravation. Again, smaller clients figure you can't win against a big company so don't complain.
>
> I would love to go to the newspapers with this and have a headline something like "Small Man Can Win Against the Big Conglomerate."

[211] There were actually four responses, although the fourth was a response from an individual on behalf of his firm.

[212] These six individuals were respondents whose cases had been decided recently.

[213] *See* Sackheim, *Administrative Enforcement of the Federal Commodities Laws By the Commodities Futures Trading Commission*, 12 SETON HALL 445, 469 (1982) (emphasizing structural drawbacks regarding the CFTC as judicial body as well as prosecutorial body). One former chairman was quoted as saying: "The agency has heard your case at least three and perhaps more times before you have a hearing. The minds of men are simply not supple enough to judge a defendant's culpability fairly when vindication and reputation are also at stake in an adversarial proceeding." *Id*.

[214] *See* Van Smith, ***Breaking the Chains That Bind: Arbitration Agreements Versus Forum Rights Under the Commodities Futures Trading Commission Act of 1974***, 16 SAN DIEGO L. REV. 749 (1979) (pointing out strangeness of voluntary arbitration procedure). In order for a customer's pre-dispute agreement to be voluntary, 17 C.F.R.

summary and formal procedures as fair in the abstract, he believed that the ALJ's did not have an understanding of the practical side of the commodities futures business and that this lack of understanding gave the ALJ's a pro-complainant bias. He felt that the NFA's process, by contrast, yielded more balanced and predictable results because the arbitrators had a better understanding of the industry.[215] His perception also was that arbitration was "a lot quicker" than reparations. Significantly, he regarded the absence of an oral hearing in summary cases to work to the advantage of respondents, since they, unlike most respondents, would be represented by counsel and thus better equipped for writing briefs.[216]

From these few contacts with recent users, a number of impressions about the workings of the reparations process emerge. First, approximately 75% of the complainants in this process are *pro se*, that is, unrepresented by counsel.[217] These complainants are not particularly sophisticated, and this is somewhat disturbing, given the sometimes complex nature of the transactions which are the subject of dispute.[218] Second, the difficulty in locating individual respondents seems to be characteristic of these proceedings. Several of the complainants noted that they had won their case but had received no monetary compensation, presuming that the respondent could not be located or was insolvent. Indeed, one major regulatory consequence of the reparations pro-

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section 180.3 states that a bold-face-type clause must be inserted to advise customers that they do not have to agree or submit to arbitration and that if they should agree, they may be waiving the right to a court proceeding. However, as the author points out, few customers will read and understand the agreement when they open an account. At best they will glance over the documents and then sign. *Id.* at 762. This tendency thereby eliminates the advantageous effect of the section 180.3 clause of preventing fraud and mistake. *Id.*

[215] *See* Note, *supra* note 22, at 188-91 (discussing atributes NFA arbitration has regarding qualifications of arbitrators).

[216] Telephone interview with Jerry Tartar, General Counsel for a commodities brokerage house (Mar. 7, 1987). Counsel for another respondent's firm believed the reparations process to be biased in favor of complainants. The firm's counsel stated that "[p]rocedural (e.g., discovery, filing deadlines etc.) and substantive (e.g., statute of limitations) rules are frequently waived for complainants but rigidly enforced against respondents."

[217] Data from the CFTC Office of Proceedings show that for the period beginning March 1985 and ending March 1987, of the 716 reparations complaints filed, 529 (or 74%) were from complainants acting *pro se*.

[218] *See* 1984 CFTC ANN. REP. 103-05. The 1984 CFTC Annual Report highlighted some of the decisions which concerned intricate arguments over whether (1) an amendment to the Commodity Exchange Act retroactively barred the Commission from jurisdiction over unregistered respondents in reparations proceedings begun before the effective date of amendment; (2) privilege against self-incrimination attached to a response to complainant's allegations; and (3) whether tape recordings of conversations should have been barred under California law. *Id.* at 103-05.

gram is that respondents who lose, and who then default on the judgment, are barred from registration in the industry until they satisfy the judgment. To enforce this regulation, the Office of Proceedings keeps a hefty sanctions list of such individuals, and provides the NFA (which is responsible for the industry registration process) with constantly updated lists.[219] Finally, the few respondents, both individual and institutional, who did respond seemed to believe that the reparations process was biased against them.

B. *Review of Case Files*

The review of the files of reparations cases in the CFTC's Office of Proceedings confirmed and reinforced the impressions gained from the survey discussed above.[220] The parties to these cases, like the parties covered in the survey, tended to conform to a repeating profile. The complainants were unsophisticated, unrepresented individuals, respondents were itinerant and hard to find, and respondent firms were frequently represented by experienced counsel.

Docket No. 86-R56 serves as our prototypical case. The complainant was *pro se*, and almost all his correspondence was by hand, and quite unsophisticated. The respondent was represented by counsel and all pleadings and motions had the form and language of documents filed in court. The complainant elected the voluntary procedure, while the respondent elected the summary procedure. After discovery had been completed, and a pretrial order issued, the complaint was settled for $650.[221]

In another case, however, an eighty-nine year old leukemia victim, barely able to communicate, won a summary decision against a major wire house. In this case, as in several others where the amount in controversey was less than $10,000, the agency clearly did not demand of the complainant the kind of rigid adherence to form and expression typically expected in civil court. On the other hand, when the complainant was seemingly sophisticated, he or she was given no special assistance.[222]

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[219] The most recent annual compilation of defaulting respondents is entitled *1984, 1985 and 1986 Reparations Sanctions in Effect List* (Dec. 31, 1986). It lists 472 individuals or firms whose failure to satisfy a judgment or settlement has caused their registrations to be suspended by the CFTC.

[220] Approximately sixteen complete case files were reviewed. Eleven had been selected by the Director of the Office of Proceedings to represent cases that had been processed slowly, moderately, or quickly, and the others were chosen by the Director to represent the three forms of procedure.

[221] There was nothing in the file to indicate how that figure was derived.

[222] In one case, in which the allegation was unauthorized trading, the issue was

Formal proceedings can be very complex and protracted if they go to decision. One particular case involved an individual suing against a major wire house. The amount claimed was $120,000, the case was accompanied by extensive briefs and interrogatories, and produced a transcript of more than 450 pages. The complainant eventually lost — essentially on the issue of credibility.

A brief time study[223] of the sample slow, medium, and fast cases both confirms the impression that the reparations process has been too slow and also gives some clues as to where the time delays occur. The most alarming set of figures from these 11 cases[224] was the category representing the number of days from receipt of the complaint by the Hearings Section to the disposition of the case — 388 days. More than a year, on average, elapsed between the completion of pleadings and the decision in what are supposed to be cases disposed of "summarily." As noted above, the problem may be a simple one of staffing, remediable by adding another judgment officer to the staff of the Office of Proceedings.

AVERAGE NUMBER OF DAYS FOR COMPLETION OF DIFFERENT STAGES OF THE CFTC REPARATIONS PROGRAM

Type of Procedure	*Receipt by Complaints Section to Completion of Pleadings*	*Completion of Pleadings to Forwarding to Hearings Section*	*Receipt by Hearings Section to Disposition*	*Receipt by Complaints Section to Disposition*
Formal	86	96	334	516
Summary	133	45	388	565
Voluntary	81	66	109	256
All	106	67	317	491

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essentially one of credibility between the complainant and respondent, and the respondent won.

[223] The agency keeps manual records of the progress of the case through the process, although the Office of Proceedings is now in the process of computerizing its record. Based on these records, an average number of days was tabulated for the time it took to process these eleven cases. This time period was broken down into the time elapsed during the different stages of the process.

[224] The average number of days was determined for four categories: (1) receipt by Complaints Section to completion of pleadings; (2) completion of pleadings to forwarding to Hearing Section; (3) receipt by Hearing Section to disposition; and (4) receipt by Complaints Section to disposition. These figures were based on the type of adjudication chosen - formal, summary, or voluntary.

The other set of troubling figures is the time it takes from completion of the pleadings to forwarding the case to the Hearings Section.[225] Even allowing for a review period to assure the pleadings are in order, the interval between completion of pleadings and forwarding to the Hearings Section is too long. The Director of the Office of Proceedings assures, however, that the delay in forwarding complaints to the Hearings Section has ended and that complaints are now forwarded almost as soon as the pleadings are complete.[226]

C. *Informational Materials Furnished to Parties*

The agency tries to be both informative and clear in the written materials it provides to individuals requesting information about the reparations process. Upon request, an informational booklet containing a complaint form is sent to a prospective complainant. Although the informational materials are helpful, the complaint form can be intimidating to the average lay complainant.[227] The Office of Proceedings, only recently digging out from the avalanche of claims of the late 1970's and early 1980's, can be forgiven for attempting to guard against the tyranny of the telephone.[228] Nonetheless, if the purpose of the program is to provide a dispute resolution process geared to relatively unsophisticated nonlawyers, the Commission needs to increase its efforts to make the process intelligible to such people. It should be emphasized that the personnel in the Office of Proceedings seem committed to making the process work for the unsophisticated complainant. There is a fine line between helping a complainant and prosecuting the case on his or her behalf, but the personnel in the Office of Proceedings seem committed to actively assist those in need of help.

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[225] The time elapsed in this category was 96 days for a formal action, 45 days for a summary action, and 66 days for a voluntary action.

[226] A brief review of the case-progress records for cases docketed since July of 1986, indicates that he is correct. The Office of Proceedings now assigns cases to an ALJ or judgment officer within one or two days of completion of the pleadings. Letter from R. Britt Lenz, Director, Office of Proceedings, CFTC, to Marianne K. Smythe (Apr. 23, 1987) (discussing ALJ assignment under new procedure).

[227] A concise, seventeen page booklet is provided upon request entitled *Questions & Answers About How You Can Resolve A Commodity Market-Related Dispute*. This booklet also contains a double-sided, single sheet complaint form. Included with the packet is a "complaint checklist" and another booklet entitled *Alternatives to CFTC Reparations: Other Ways to Resolve Futures-Related Disputes*.

Although the complaint form is short, it may still be confusing to the lay reader in two respects. First, it asks the complainant whether the individual respondent or the firm was registered at the time of the alleged violation, but the form does not explain why this is important. The importance of determining registration is outlined in the booklet, but not on the form. Second, the form asks for a detailed explanation of "the facts which will show how the Act was violated and the way in which the complainant was injured by that violation." The requirement for detail and specific facts could be intimidating to the average lay complainant.

[228] The form states as follows:

> Because of the large volume of reparation claims pending in this office, we ask that you refrain from telephoning except at our request. If you must contact us, please refer to the docket number above. We are in the process of reviewing your claim. You will be contacted as soon as any further action is taken on your claim.

VII. THE APPELLATE PROCESS

As noted above, the new CFTC reparations rules modify the appellate process in one significant respect. They terminate the certiorari procedure and the double briefing, and instead institute an appeal as of right.[229] The new rules also delegate significant authority to the Chief of the Opinions Section to remand cases to the Office of Proceedings for a variety of reasons, including procedural mistakes, lack of clarity in the decision, or a record insufficient to support the decision. A centralization of management in the Opinions Section, with a greater insistence on adherence to required filing deadlines, has relieved the backlog of cases at the appellate level.[230] The goal, which is presently being realized, is to have all cases current to the fiscal year.[231]

CONCLUSION

A. The CFTC Reparations Program

The reparations program at the CFTC has struggled for nearly 13 years to become a useful forum for dispute resolution. The placement of such an experimental program in a new agency, with many other problems to resolve, contributed to the uncertain fortunes of the program. Since the program's restructuring in 1982, a number of factors have led to a more efficient treatment and disposition of reparations cases within the agency. These include the fortuity of a quiet market, and the recent availability of other forums to which commodity customers may bring complaints. Additionally, the CFTC has paid more attention to the management of the program and has provided it with additional resources.

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[229] 17 C.F.R. § 12.401 (1987).

[230] The CFTC Annual Report for 1986 shows that the number of cases pending at year-end in the CFTC appellate docket for reparation cases has steadily declined in the last four fiscal years. There has been a uniform decline of pending cases of at least thirty per year: from a high of 177 in fiscal year 1983, to the current low of 71 pending cases in fiscal year 1987. During these years the CFTC has dramatically increased the number of orders and opinions issued.

[231] Interview with Jerome Nelson, Chief, Office of Opinions and Review, CFTC (Mar. 26, 1987).

The extent to which the creation of new procedures has contributed to the improved efficiency of the reparations program is a complex question. The reduction of procedures, as evidenced in the highly experimental voluntary process, has shortened the time necessary for the decisionmaker to render a decision once the pleadings are complete. The less experimental summary process should in theory also have shortened case processing time, but these economies have been compromised by the resource constraints on the Office of Proceedings.

Increased decisional authority delegated to judgment officers, rather than to ALJ's, has the potential for improving efficiency through exerting supervisory control over such employees. No amount of control, however, can substitute for a sufficient number of decisionmakers. The analysis of decided cases suggests that the two judgment officers at the CFTC are overburdened. The relatively slow processing time for complaints heard under the voluntary and summary procedures may also be caused by a lengthy discovery process, which is the same for the formal procedure. Substantial time savings could result if a streamlined discovery process is developed to comport with the streamlined decisional processes.

The one notable personnel *addition* contained in the new rules, having a proceedings officer function as a magistrate, did not turn out to be a successful innovation. The incumbent proceedings officer left the agency in September 1986 and had not been replaced as of April 1987. It is unclear whether the idea of such a functionary is flawed, or whether the problems were less those of structure than of personality. Two ALJ's refused from the outset to permit the proceedings officer to preside over their cases, and another, who did permit such access, subsequently decided that the proceedings officer had created a bottleneck. The two ALJ's who resisted using the officer had theoretical objections to the role. They believe that a judge's involvement in discovery and pretrial skirmishing is a necessary part of understanding a case.

Another innovation of the new rules for the formal procedure is the limitation on hearing sites to 20 cities. This has not been strictly enforced, however, because better program management has made such restrictions unnecessary.[232]

The telephonic hearing concept is the most noteworthy invention of the new summary procedure. It is regarded by one judgment officer as a useful innovation,[233] yet another finds it questionable. Part of the problem with its use is the cost: upwards of $200 may be charged for one telephonic hearing. Neither judgment officer currently at the Commission, however, expressed being fully comfortable with a process that depends heavily on a paper hearing for fact-finding. Both regard the opportunity actually to hear the contestants as an important fact-finding tool.[234]

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[232] Interview with R. Britt Lenz, Director, Office of Proceedings, CFTC (Mar. 27, 1987).

B. *The CFTC Reparations Program as a Model for Other Programs*

Beyond the performance of the reparations program at the CFTC, the broader utility of such an ADR program for other federal agencies will depend essentially on one question: whether value is ascribed to expert government employees serving as judges of private disputes arising under a federal regulatory program. The benefits to aggrieved consumers seem obvious. An expert and impartial judiciary is provided, along with some opportunity to choose a process with procedural protections commensurate with their perceived needs. Although the process at the CFTC has had a troubled history, the prototype process provides a potentially useful model for other agencies with a consumer protection mission, such as the Securities and Exchange Commission or the Consumer Products Safety Commission.[235]

The benefits of a reparations process to a regulated industry are less obvious. There is a perception that the CFTC's reparations process has a pro-complainant bias, suggesting that the presumed benefit of an *impartial* judiciary is not necessarily evident to everyone. The cases decided by CFTC reparations judges were not, however, notably more pro-complainant than those decided by the NFA arbitrators. Therefore, the perception of pro-complainant partiality may not be valid.

The benefit to a regulatory agency of having a reparations program should also be obvious. First, a reparations program provides a valuable source of information to the agency about the problems in the regulated industry. Much of the important sales-practice law in the commodity futures industry has been articulated by the CFTC in cases heard on appeal from an initial reparations decision. Secondly, a *government-sponsored* ADR forum serves as a useful alternative to industry-run arbitration programs. If the commodity futures industry perceives bias in the CFTC reparations program, an equal and opposite perception probably exists among consumers with respect to industry-sponsored arbitration fora. Because of this, somewhat duplicative agency and private dispute resolution fora serve as useful checks on perceived pro-complainant or pro-industry bias.

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[233] Interview with Judgment Officer Joost, CFTC (Mar. 4, 1987).

[234] Interviews with Judgment Officers Joost and Phillips, CFTC (Mar. 4, 1987).

[235] Agencies other than the CFTC have reparations programs. Other than the Department of Agriculture's program, the progenitor of the CFTC program, many of the programs center around disputes involving common carriers. For example, the Federal Maritime Commission has a reparations program to mediate certain disputes between ocean common carriers, 19 U.S.C. § 1641(i) (1982), and against "common carrier[s] by water in interstate commerce," 46 U.S.C. § 821 (1982), and for alleged rate overcharges, 46 U.S.C. § 845a (1982). *See also* 46 U.S.C. § 1704 (d) (1982) (concerning reparations with assessment agreements); 46 U.S.C. § 1710(g) (1982) (concerning reparations amongst common carriers, ocean freight forwarders, and marine terminal operators). The Interstate Commerce Commission's reparations authority relating to common carriers is now 100 years old. 49 U.S.C. §§ 908, 916 (1982).

For a federal agency reparations program to be successful as an ADR forum, it needs adequate resources. No amount of procedural innovation will substitute for the number of personnel minimally necessary to hear cases, and the equipment to automate and speed the paper trail of the adversarial process. If one lesson can be drawn from the CFTC experience, it is that inadequate resources will make for a struggling program.

A reparations program probably will always have to fight for the resources and attention that more traditional agency programs, such as rulemaking and enforcement, enjoy. The slow, somewhat unglamorous business of presiding over individual claims will be regarded by many as low in prestige and, therefore, a low-priority undertaking. Moreover, the government's providing to the lay citizen an opportunity for redress against an industry monolith may not please the industry monolith. Pressures from industry on the agency and on key legislators likely will not be in the direction of increasing resources for such programs. As the satisfaction evident in the victorious claimant suggests, however, the availability of such programs is an important service provided by the government to its citizens, and one not to be disparaged.

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